



New England States Committee on Electricity

To: NEPOOL
From: NESCOE
Date: April 7, 2017
Subject: Feedback to NEPOOL on Long-Term “Achieve”-style IMAPP proposals

Summary

NESCOE considers NEPOOL’s Integrating Markets and Public Policies (IMAPP) a success in that it has identified mechanisms that have the potential to advance state-level clean energy mandates through regional competitive wholesale markets. The states appreciate NEPOOL’s time and effort and the work of market participants that have contributed to this important dialogue.

As noted at the outset of the IMAPP process, the New England states have a variety of mechanisms available to them through which to execute the requirements of state laws. The states have not, however, had a viable option in the form of a pricing mechanism directly connected to the wholesale competitive markets and appreciate the opportunity to explore that potential.

This memo provides NESCOE’s feedback at this juncture on the long-term “achieve”-style proposals that market participants have proposed in NEPOOL’s IMAPP process. These generally fall into two categories, a Forward Market Design (FMD) and a form of carbon pricing.

With respect to an FMD, states with forward-looking needs to satisfy the requirements of their respective state laws are interested in further analysis of these potential mechanisms. NESCOE believes market participants have developed potential frameworks to a sufficient level of detail such that NESCOE is able to conduct further analysis of these mechanisms and their interactions with the existing market structure in the context of its *Renewable and Clean Energy Mechanisms 2.0 Study* (Mechanisms 2.0 Study).

Further, NESCOE confirms that it does not support an additional¹ carbon pricing-style mechanism in furtherance of state laws, which would be administered by ISO New England (ISO-NE) and regulated by the Federal Energy Regulatory Commission (FERC).

¹ The New England states have a carbon pricing mechanism available to them in the form of the Regional Greenhouse Gas Initiative (RGGI), in which states have participated pursuant to the authority of each state’s laws since 2009.

By way of next steps, NESCOE's Phase II of the Mechanisms 2.0 Study will provide analysis of a variety of mechanisms that states could employ to meet the requirements of their clean energy mandates. This analysis will assist the New England states' understanding of the potential consumer and other implications of various options, including state-jurisdictional mechanisms and a form of FMD. NESCOE also plans to assess ISO-NE's recommended approach to a short-term, "accommodate"-style proposal when ISO-NE makes it available along with other mechanisms.

Given the very small level of procurements completed to date pursuant to state laws – a few hundred (nameplate) megawatts – and the lengthy processes required before any such further procurements are concluded,² New England has the benefit of time to sort through market and/or other changes that may be required over the long-term in a way that is thorough and holistic. This includes, but is not limited to, policies and/or programs related to carbon reduction, storage, and distributed generation. NESCOE looks forward to discussion about the design of the future grid and associated market rules. This includes, for example, the relative size and proper form of the ancillary service markets, ISO-NE's examination of ramp pricing in the context of a wholesale market with a higher level of variable resources, and understanding the effect of the recently implemented fast start pricing and sub-hourly real-time settlement market rules that the states supported. NESCOE looks forward to continued collaboration with NEPOOL and ISO-NE on these important matters.

Context

Historically, when competitive markets have not produced the resources to meet state objectives, states have had a variety of mechanisms available to execute the requirements of state laws, such as Renewable Portfolio Standards and power purchase agreements. There has not until now, however, been a pathway tied directly to the wholesale competitive markets.

Beginning in the summer of 2016, market participants have worked diligently in the IMAPP process to develop potential mechanisms that might better integrate the requirements of state laws and wholesale competitive market design. Since the first IMAPP "pause" in late 2016, market participants have worked constructively to try to understand and address the issues states identified in a memo to NEPOOL dated September 30, 2016 (NESCOE Memo).³ Proposal proponents have also spent time with states collectively through NESCOE and individually to ensure a clear understanding of concerns and proposals. NESCOE appreciates proposal proponents' efforts and responsiveness.

Over the course of 2016, and since the January 25, 2017 IMAPP meeting, states have dedicated time to assess and discuss the long-term "accomplish"-type proposals.

² See <https://macleanenergy.com/83d/83d-timeline/> for an example of procurement timelines.

³ See http://nepool.com/uploads/IMAPP_20161006_IMAPP_Objectives_to_NEPOOL_9_30_16.pdf.

Concurrently, as noted at the outset of the IMAPP process, NESCOE has been conducting its Mechanisms 2.0 Study.⁴ This study followed a related mechanisms whitepaper NESCOE published in December 2015.⁵ The purpose of the Mechanisms 2.0 Study is to: 1) examine energy and capacity markets under various hypothetical future market conditions (Phase I), and 2) assess various mechanisms, such as renewable portfolio and clean energy standards, power purchase agreements, strategic transmission investments, and centralized auction-based procurement (Phase II). Of course, producing information about a variety of mechanisms is not intended to, and should not be interpreted to, suggest a preference for any mechanism. NESCOE has completed Phase I, the scenario analysis, and is working on Phase II, the mechanisms analysis.

ISO-NE and long-term FMD proposal proponents have provided states with a solid understanding of the myriad issues associated with a centralized auction-based procurement approach and with practical information about how it could be implemented. NESCOE has sufficient information to enable its further comparative analysis in the Phase II of the Mechanisms 2.0 Study.

Interest in Continued Exploration of Long-Term Forward Market Designs

States continue to assess FMDs and the circumstances in which an FMD would make sense in the context of state laws and for consumers. States that foresee further clean and renewable energy needs remain interested in continuing to explore the advantages and disadvantages to an FMD, and should the former outweigh the latter, to explore work-arounds to any impediments.

As a threshold matter, the states continue to focus on the basic questions identified early in the IMAPP process, the answers to which help inform whether the potential benefits of an FMD outweigh any shortcomings. Those questions include:

1. On a going forward basis (after current procurements are concluded), what level of expected procurement activity would make development of an FMD worthwhile?
2. What would a procurement cycle look like? (e.g., 200 MW every year, 500 MW every three years, 1,000 MW every five years)?
3. Whether there is demand potential for a homogenous resource type in order to create a larger procurement level so that, for example, 70% of the expected purchases could be procured under a forward, centralized design with a remaining state-specific 30% procurement by individual states?

⁴ See <http://nescoe.com/resource-center/mechanisms-study-jun2016/>.

⁵ See *Mechanisms to Support Public Policy Resources in the New England States* at <http://nescoe.com/resource-center/mechanisms-dec2015/4/>. That paper identified a range of mechanisms available to states to support resources required by state laws, such as clean energy standards, contracting, and cap and trade programs. It described each mechanism's mechanics, as well their interaction with the competitive wholesale markets and some legal and regulatory issues.

4. Whether state specific evaluation criteria can be factored into a FMD?

The states understand the potential benefits of a longer-term centralized auction platform design. Most of these benefits align with the benefits of the transition to competitive wholesale markets.⁶ In particular, the states see value in seeking to design a competitive market mechanism that can achieve state policy objectives while appropriately allocating resource investment risk to investors. The states are interested in continuing to explore market designs that allow the states to achieve the requirements of state laws while retaining competitive wholesale markets. Phase II of the Mechanisms 2.0 Study discussed above provides NESCOE an opportunity to consider some of the key design elements of an FMD. The states hope to use the study results and stakeholder outreach to inform potential design considerations of a market-based solution. The states looking forward to sharing those results with market participants, NEPOOL, and ISO-NE.

Feedback on an ISO-NE Administered and FERC Regulated Carbon Pricing Proposal

The New England states have for a decade collectively supported carbon pricing in the form of RGGI, a cooperative multi-state effort to reduce greenhouse gas emissions.⁷

The states have carefully reviewed the current carbon pricing-style proposals. The states recognize and appreciate that IMAPP proposal proponents have modified various carbon pricing-style proposals to address the consumer cost and cost allocation concerns that NESCOE first identified in the fall of 2016. The states at this time do not, however, support an additional, separate carbon pricing-style mechanism that would be administered by ISO-NE and subject to FERC jurisdiction to execute the requirements of various states' laws.

The states' rationale, informed by conversations and revised proposals as the IMAPP process progressed, is similar to those NESCOE identified in the fall of 2016. The states' continuing concerns about a FERC-jurisdictional tariff reflecting carbon pricing to execute the requirements of some states' laws include:

1. The imperative that states determine the specifics associated with the execution of state laws. The importance of state self-determination in connection with the implementation of its carbon-reduction laws, which have consumer cost and other policy implications, is self-evident.

NESCOE offers two examples to illustrate the concern. First, recall that ISO-NE, NESCOE and NEPOOL agreed on core aspects, including roles and responsibilities, of New England's compliance filing on FERC's Order 1000

⁶ For restructuring background and other information, see http://nescoe.com/wp-content/uploads/2015/12/RestructuringHistory_December2015.pdf.

⁷ The RGGI states' Memorandum of Understanding was signed by all states in 2007. The first compliance period began in 2009.

public policy provision. Despite that agreement, FERC's New England order shifted decision-making about the specific means by which to implement state laws away from state officials and to ISO-NE. Mindful of this recent example, even if the region hypothetically could reach agreement about a carbon pricing-style mechanism structured and governed in a way that satisfied state officials, the states have no risk tolerance for a FERC order, whether initially or in response to a later complaint (see second example below), that seeks to shift responsibility to ISO-NE or any other entity over the form and/or level of a carbon price to satisfy state laws.

Another related example that gives states considerable pause is the risk that one or more market participants would seek changes, after-the-fact, to any regionally supported outcome they would have preferred had gone another way. A few years ago, ISO-NE, NEPOOL and NESCOE collectively supported the Renewable Technology Resource Exemption in the Forward Capacity Market as part of a package of reforms. Certain generators have continued to litigate the exemption. This creates uncertainty regarding an important component of an overall package of changes that NESCOE considered. Generating entities' after-the-fact challenge to the Peak Energy Rent mechanism has similar echoes. In the context of a wholesale market mechanism to implement state laws, the states have no tolerance for the risk, borne out in recent years, that a few market participants with an appetite and budget to litigate matters will seek to disrupt a design over which ISO-NE, NESCOE and NEPOOL had found agreement.

2. Continuing concerns over increasing energy costs that would be related to any carbon pricing-style mechanism proposal.
3. Continuing threshold legal questions about FERC's and/or ISO-NE's legal authority to establish and set the level of a specific carbon price in the locational marginal price of energy.
4. Continuing legal questions about state officials' authority to support the form or level of a carbon pricing-style mechanism in the context of an ISO-NE tariff.
5. Interaction with New England states' existing carbon-related support mechanism, RGGI.
6. The risk of providing certain existing resources that already receive economic support through other state programs incremental support through an ISO-NE administered carbon pricing-style mechanism. Consumers would pay for both.
7. The consumer cost risk associated with creating an increased revenue stream, whether needed or not, applicable to all non-carbon emitting resources without identifying the conditions under which such need would be determined. The states are concerned about the potential to increase consumer costs without any corresponding consumer benefit. Such result would be especially concerning if

the actual need for this revenue increase is limited to a single resource type (for example, nuclear resources that may be needed for reliability and that have sufficiently established financial distress).

8. Allocation of any over-collection of emission fees.⁸

We look forward to reviewing ISO-NE's proposal this spring and participating with ISO-NE and market participants in discussions about the way forward in the near-term. We believe that continuing to work together with ISO-NE and NEPOOL on potential near- and longer-term approaches is the best way to sort through the complex challenge of preserving the benefits of competitive wholesale markets while the states execute the requirements of state laws. We commit to continuing active engagement and timely feedback as we all consider the grid of the future and associated market rules.

⁸ See Rebate Allocation, page 4, at http://nepool.com/uploads/IMAPP_20170125_ISO-NE_Discussion_Paper_Rev.pdf.