

## UNITED STATES OF AMERICA 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.**

**AD 17- 11 - 00**

The undersigned Pennsylvania Commissioners Emeritus are pleased to submit these comments in advance of the May 1 and 2 Technical Conference on state policies and their interface with the competitive wholesale markets in New York, New England and PJM. We applaud the Commission's leadership in inviting this important and timely conversation. As former commissioners who served in the early days of the PJM markets, who worked closely with PJM and the Commission to develop the rules to support efforts to bring about the benefits of markets to consumers and who believe in the promise that competitive markets still hold for Pennsylvania and the entire PJM footprint, we are pleased to offer these comments.<sup>1</sup>

As an initial matter, it is important to recognize that both state and federal policymakers have roles to play in the formulation of public policy regarding the production and delivery of electricity to consumers. In certain areas, the role for state policymakers is clear (the development of rates for retail distribution) and in other areas the role for the FERC is clear (the setting of wholesale rates for resale); however, as technology, consumer demands, political priorities and competitive power markets evolve, the traditional lines of jurisdictional demarcation are not as clear as they once were.

In regard to the PJM region, this lack of a clear line has led to proposed tariff revisions by PJM, complaints adjudicated by FERC, and litigation that stretched to the United States Supreme Court. Regardless of the forum, state policy initiatives that influence the wholesale market to the benefit of a certain resource have been a consistent reality of the PJM market that is intentionally designed to be agnostic to the type of generation constructed and dispatched.

PJM is first and foremost an interstate market. Fourteen separate political jurisdictions (13 states and the District of Columbia) participate in the PJM market and the very nature of a regional market lends itself to federal oversight. The framers of our Constitution recognized the need for federal oversight of interstate trade and the same logic that led to that conclusion

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<sup>1</sup> These comments are being submitted as the personal views of the signers and do not necessarily represent the views of any clients, employers or other entities affiliated with the signers. These comments are not meant to endorse any specific market rule or policy, but rather to underscore the importance of well-functioning markets and FERC's critical role in maintaining them.

can be applied to the interstate power markets. States have a natural and understandable motivation to act in their self-interest. Federal regulation of interstate commerce prevents that motivation from becoming punitive or inequitable.<sup>2</sup>

That said, state policymakers, particularly state utility commissions including Pennsylvania, played an enormous role in the development of PJM as an interstate power pool and the transformation of PJM in the interstate power market that it is today. In the late 1990's, many states in the PJM footprint were motivated to restructure their electric utilities in order to bring the benefits of competitive market to the generation sector. With the development of non-utility generation and the promulgation of FERC Orders 888 and 2000, states saw an opportunity to bring the benefits of competitive generation to consumers. States realized that the competitive power rates were lower than the embedded cost of services rates for generation, states saw the technology advances that the competitive telecommunications market brought to that utility, and states seized the opportunity to bring these same benefits to the competitive power generation space. Legislatures passed laws, governors signed bill and state commissions oversaw massive restructurings of their utilities - - all with the goal of bringing the benefits of competitive generation to their respective state's consumers.

As part of this transition, many tough decisions needed to be made by state policy makers. Among other things, state regulators evaluated and adjudicated stranded costs claims. Traditional utility programs for conservation and low income consumers had to be modified. Consumers were educated on how to evaluate offers from competitive suppliers while competitive suppliers needed to be licensed and regulated so as to protect consumers.

While it may have been overlooked and unappreciated at the time, the transition of the wholesale markets in order to support the competitive retail market was driven by state regulators in the PJM footprint.<sup>3</sup> State regulators recognized that the success of the retail market was inextricably dependent on the success of the regional wholesale market.<sup>4</sup> Reliability was a priority for state regulators and control of generation adequacy was being moved from the state level (through the IRP process) to the FERC-regulated RTO level. Instead of state regulators deciding that a new power plant was needed after a prudency review, many

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<sup>2</sup> See, *Public Utilities Commission of Rhode Island v. Attleboro Steam & Electric Co*, 273 U.S. 83, the sale of electricity between Rhode Island and Massachusetts is "a transaction in interstate commerce" and hence beyond the authority of either state to regulate.

<sup>3</sup> For example, "... the continued success of our retail market hinges upon the development of competitive wholesale markets. Therefore we have a keen interest in furthering the development-efficient, wholesale energy markets with transparent prices that reflect transmission congestion. Transparent prices are the backbone of retail competition and along with that, Illinois's is interested in working collaboratively with other state regulators, with PJM interconnection and Midwest ISO, and with the FERC to find regional solutions for regional problems." Comments of Illinois Commissioner Kevin Wright, PJM Technical Conference with States and Market Participants, Docket No. RT01-2-000

<sup>4</sup> See, <https://elibrary.ferc.gov/idmws/common/opennat.asp?fileID=9059174>

states in PJM affirmatively decided to rely on private investment of at risk capital based on market signals in order to fulfill the generation needs of the region. Such a change in policy was not without risk, but these states appreciated those risks and moved forward accepting those risks because of the anticipated benefits of competitive wholesale markets.

In addition to provision of adequate generation resources, the pricing of those resources was moved to the purview of the regional market. Bid-based pricing and locational marginal pricing were introduced in 1997. State commissions in the PJM footprint were very active in the FERC proceeding to establish a bid based market for energy in PJM.<sup>5</sup> New Jersey, Maryland, Pennsylvania, Virginia, Delaware, Illinois, Indiana, Ohio and the District of Columbia all played very active roles in the transformation of PJM from an interstate power pool to a Regional Transmission Organization and a competitive regional wholesale power market<sup>6</sup>. State regulators actively promoted the creation of an independent board of directors to oversee PJM<sup>7</sup>. States encouraged FERC to expand PJM to other regions.<sup>8</sup> States even encouraged the standardization of market rules across RTO's.<sup>9</sup>

The cooperation between state commissions and FERC was extraordinary during this period of time. Countless public and private meetings occurred between regulatory staffs and commissioners all with a common goal of creating a robust regional market. Indeed, FERC pushed for the creation of the Organization of PJM States (OPSI) to formalize a role for state commissions.<sup>10</sup> State commissions did not always agree with each other and FERC did not always agree with the proposals offered by individual states or the collective states, however, decisions were made and the markets advanced.

States were at the table at every step throughout this process and knew that many issues were moving from their regulatory purview to that of FERC, because the states understood the tremendous advantages of being in an RTO.<sup>11</sup> More efficient transmission systems, access to low cost resources across a broad geographic footprint, and improved reliability with lower reserve margins were just some of the supporting reasons that states

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<sup>5</sup> See generally OA97-261. Delaware Chair Arnetta McRae offered the following thoughts in 2003, "Now on locational, marginal pricing, let me say, and make it very, very clear, that Delaware and many other states in MACRUC support the notion that locational, marginal pricing is the way to go." PJM Technical Conference with States and Market Participants, Docket No. RT01-2-000.

<sup>6</sup> See generally, <https://www.ferc.gov/CalendarFiles/20030819184538-08-19-03-aug28.pdf>

<sup>7</sup> "The MACRUC states firmly support the concept that RTO boards must be independent of all market participants, as well as having no financial interest in any of the market participants' activities," New Jersey Commissioner Frederick Butler, PJM Technical Conference with States and Market Participants, Docket No. RT01-2-000.

<sup>8</sup> <https://elibrary.ferc.gov/idmws/common/opennat.asp?fileID=9543925>

<sup>9</sup> [http://www.puc.state.pa.us/about\\_puc/press\\_releases.aspx?ShowPR=931](http://www.puc.state.pa.us/about_puc/press_releases.aspx?ShowPR=931)

<sup>10</sup> See, William Smith, *Formation and Nurture of A Regional State Committee*. P 189-190. <http://www.felj.org/sites/default/files/docs/elj281/185-205.pdf>

<sup>11</sup> FERC conducted its own studies of the benefits states would enjoy from RTO membership in 2002. [https://www.ferc.gov/legal/maj-ord-reg/land-docs/RTOSTudy\\_final\\_0226.pdf](https://www.ferc.gov/legal/maj-ord-reg/land-docs/RTOSTudy_final_0226.pdf)

expressed for joining a RTO. As the Pennsylvania Public Utility Commission wrote to the Commission in 2003, “The interests of ratepayers are best served by bringing greater regional competitive forces to bear on wholesale and retail energy prices, not by indulging the proprietary interests of local monopolies. Competition can best be promoted by the continued expansion and development of a seamless transmission network and wholesale energy markets administered by RTOs.”<sup>12</sup> History has proven the states correct as PJM currently estimates its total annual value to consumers at \$2.8 to \$3 billion.<sup>13</sup>

As part of the move to competitive regional markets, states realized that there could be implications for their environmental priorities. By relinquishing control of certain matters involving power generation, the states were required to think regionally about environmental strategies. As an example, Pennsylvania Governor Tom Ridge recognized that Pennsylvania’s transition to an open market for generation could cause an increase in power flows from states to the south and east of Pennsylvania that, at the time, had less stringent air pollution requirements.<sup>14</sup> As a result, Pennsylvania along with Connecticut, Maine, Massachusetts, New Hampshire, New York, Rhode Island and Vermont specifically petitioned the EPA to develop a 37-state NOx standard that would be achieved through a regional cap and trade system.<sup>15</sup>

In the fifteen years since PJM became a RTO, there have been numerous attempts by states to reclaim some of the regulatory jurisdiction that was relinquished in the early part of the century. New Jersey and Maryland promoted regulatory schemes that were judicially determined to set the wholesale price of power in contravention of federal law and the Supremacy Clause of the Constitution.<sup>16</sup> While the motivations of New Jersey and Maryland were slightly different, the conversations that led to the state policies are instructive. During the state level debates concerns were expressed about reliability, congestion, wholesale prices, power imports from other states, and the inability of wholesale power markets to develop new generation. As a general matter, while all of these issues are important to state regulators,

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<sup>12</sup> See Comments of the Pennsylvania Public Utility Commission, Docket No. ER03262-001, Sept. 28, 2003.

<sup>13</sup> <http://www.pjm.com/about-pjm/value-proposition.aspx>. Note that these savings do not include savings that consumers may enjoy from competitive retail energy markets. To the extent that individual states introduce competing policies or subsidies that disrupt the wholesale market, there is a great risk that the benefits of both competitive wholesale and retail markets will be lost.

<sup>14</sup> Speech of Governor Tom Ridge to the Pennsylvania Electric Association. Hershey, PA, September 18, 1996.

<sup>15</sup> See, <http://www.pabulletin.com/secure/data/vol30/30-39/1632.html>. EPA eventually granted the petition of the Northeast states and Governor Ridge offered the following comment which recognized the importance of regional environmental solutions: “Since 1995, we have advocated a regional solution to our air-pollution problems because dirty air coming into Pennsylvania from other states already was at or above EPA’s ozone health standard. By granting our petition, EPA again recognized that one state alone cannot solve the ozone-pollution problem. Every state has to do its fair share.” See, <http://www.prnewswire.com/news-releases/gov-ridge-issues-statement-on-epa-decision-to-grant-pas-clean-air-petition-77699482.html>

<sup>16</sup> See, *Hughes v. Talen Energy Marketing, LLC*, 136 S. Ct. 1288.

these issues are nonetheless under the regulatory purview of FERC as the regulator of the regional wholesale market.

Given the very nature of a regional market, it is not only appropriate, but necessary that certain regulatory decisions be made at the regional/federal level as the action of one state could impact the market of the 13 other states in the PJM region and perhaps undermine the efforts of another state to achieve its desired policy outcome. The Pennsylvania Public Utility Commission succinctly made this point to a federal court about New Jersey's efforts to advance a state interest (subsidizing a new natural gas fired power plant) at the expense of the regional wholesale market:

"The PAPUC contends that state-sponsored subsidies such as New Jersey's LCAPP are counterproductive and interfere with the efficient operation of RPM. Under the RPM mechanism, capacity prices respond to market conditions, increasing when and where capacity is scarce and decreasing when and where capacity is plentiful. When RPM's capacity prices are high, it indicates that there is demand for additional capacity and new capacity resources should be provided. When RPM's capacity prices are low, it indicates that there is no need for new capacity to enter the market and higher-cost capacity resources should be retired. These pricing signals help to ensure that there is sufficient capacity available to meet reliability requirements.

State-sponsored subsidy programs like the LCAPP program distort these pricing signals and interfere with the proper functioning of the market. When state subsidies incent generators to enter the market below their true economic costs, capacity prices fall in the short term. **This price decline affects not only the state where the subsidized generator is located but significantly impacts market operations across the PJM region and discourages capacity investment at cost-based prices.** Although this reduction in price of capacity investment may seem positive, the actual costs of distorting the market's pricing signals greatly outweigh perceived short term "benefits" resulting from lower capacity prices. Lower capacity prices reduce the incentive for new capacity to enter the market even if that new capacity would be more efficient than the subsidized generators and even if that new capacity is needed to ensure reliability. Because more efficient resources are excluded from the market by the subsidized participants, state subsidy programs result in higher prices in the long-term." (emphasis added)<sup>17</sup>

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<sup>17</sup> PAPUC Amicus Brief at 13-14, 766 F.3d 241lt. [http://www.puc.state.pa.us/General/pdf/FERC/DN\\_EL16-33-000.pdf](http://www.puc.state.pa.us/General/pdf/FERC/DN_EL16-33-000.pdf)

While states certainly have an interest and need to be constantly vigilant, informed, and proactive, the regulatory authority over the wholesale market rests with FERC. States voluntarily entered such an arrangement in the early 2000's, the courts have upheld this arrangement and the Commission should not be afraid to follow proactively continue its proper oversight and regulatory role that it was given to it by Congress through the Federal Power Act.

The Commission appropriately did exactly that in 2016 in regard to the efforts of AEP and FirstEnergy to secure a purchase power agreement (PPA) from their regulated affiliates without a competitive bid process. Under the Commission's affiliate power sales restrictions, no wholesale sale of electric energy or capacity may be made between a franchised public utility with captive customers and a market-regulated power sales affiliate without first receiving Commission authorization under section 205 of the Federal Power Act.<sup>18</sup> However, the Public Utilities Commission of Ohio approved precisely what the Commission proscribed and the Commission appropriately required the state commission-approved PPA (which was a wholesale sale of power) to be effectuated consistent with FERC standards.<sup>19</sup>

It is not the Commission's prerogative to second guess the environmental, economic or other goals of a states. As the Supreme Court specifically concluded in *Talen v. Hughes*, it is not the Commission's job to tell a state that it cannot pursue its clean generation or other goals.<sup>20</sup> It is, however, the job of the Commission, as the Pennsylvania PUC points out above, to evaluate how generation will participate in the wholesale market. FERC has exclusive jurisdiction over wholesale market rates and that extends to the evaluation of state-subsidized resource participation in those markets.<sup>21</sup> The Federal Power Act demands such a role for the Commission and the Supreme Court has affirmed that role.

We appreciate that the line between federal and state jurisdiction does not always shine brightly and, as the grid evolves, the challenge of defining such a line will likely grow. As former state policymakers, we have enormous respect and appreciation for state legislative and regulatory processes and generally believe that states policies should be given every opportunity to be effectuated. Accordingly, as the Commission considers its role moving forward, we offer the following suggestions to the Commission:

- **Work proactively with states.** Litigation between the states and FERC and/or disaffected market participants consumes resources and thwarts progress. We

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<sup>18</sup> 155 FERC ¶ 61,101

<sup>19</sup> Note that AEP and FirstEnergy eventually withdrew their respective requests for PPA's between their generation companies and their regulated affiliates.

<sup>20</sup> *Hughes v. Talen Energy Marketing, LLC*, 136 S. Ct. 1288

<sup>21</sup> *Ibid.*

would encourage FERC to become a more proactive partner to help states achieve their goals in a manner that does not disrupt the competitive wholesale market. While such a role may be new, uncomfortable at first and not always easy, it should nonetheless be considered. In most circumstances, state public policy goals can be achieved through means that do not impact the wholesale market and the Commission should actively move states in a direction that is consistent with its exclusive oversight of the interstate power market.

- **Encourage regional policy solutions.** To the extent public policies can be pursued across the region, they should be considered at the regional level and incorporated into the regional market. If a competitively neutral regional alternative is available to achieve a regional public policy goal, the Commission should be able to entertain such an idea. Policies that are “priced” into the regional market will allow the market to operate efficiently and without fear that one’s state initiative is undermining the prerogatives of another state since every state is operating under the same rules
- **Flex regulatory muscle when necessary.** Ideally, the Commission will never be put in the position of determining whether the means that a state has chosen to pursue a state policy initiative intrudes on FERC’s authority over wholesale rates. Indeed, as noted above, the Commission should pursue all reasonable alternatives in order to help the state identify the appropriate means by which to achieve its goal. Making a decision that has the effect of invalidating a state policy is not always a comfortable thing to do, but there are times when it is necessary. The Commission has shown a willingness to make such a decision when a state action has overstepped its regulatory bounds and should continue to do so when appropriate.

Pennsylvania is rightfully proud of the numerous benefits that restructured markets have brought to the Commonwealth. Two decades of bipartisan regulatory and legislative support for electric competition has placed Pennsylvania in an envious position.<sup>22</sup> As the current chair of the Pennsylvania Commission, Gladys Brown, appropriately observed, “....Pennsylvania has stood on the national forefront of electric competition, putting the power of choice in the hands of consumers and giving them greater control of their electric bills.....As a

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<sup>22</sup> See, <https://www.youtube.com/watch?v=vocwpS17CsQ&feature=youtu.be>. Remarks from Governor Wolf at 59:00 and remarks from Governor Ridge at 1:02.

result of this historic legislation, millions of electricity customers have made choices and saved money, purchased renewable products and explored innovative new offers and plans.”<sup>23</sup>

Pennsylvania has not been able to achieve this success on its own. The regional wholesale market administered by PJM and regulated by FERC is the foundation upon which this success rests. In order for this success to continue, that foundation must remain strong.

Respectfully submitted,

S/ Nora Brownell

Nora Brownell

Pennsylvania Public Utility Commission Commissioner  
1997 – 2001

Federal Energy Regulatory Commission Commissioner  
2001 - 2006

S/ James Cawley

James Cawley

Pennsylvania Public Utility Commission Chairman and  
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S/ John Quain

Pennsylvania Public Utility Commission Chairman and  
Commissioner 1993 -2001

S/ Glen Thomas

Glen Thomas

Pennsylvania Public Utility Commission Chairman and  
Commissioner, 2001 - 2005

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<sup>23</sup> See, [http://www.puc.pa.gov/about\\_puc/press\\_releases.aspx?ShowPR=3794](http://www.puc.pa.gov/about_puc/press_releases.aspx?ShowPR=3794)



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