

Four Possible Functionalities of IMAPP Reforms

Donald J. Sipe
PretiFlaherty
P.O. Box 1058
45 Memorial Circle
Augusta, ME 04332

Anything we design will need to serve a function and its design ought to depend on the function it's intended to serve. I see four possible functions for market reforms with respect to public policy. They are not mutually exclusive and may be unavoidably interdependent in some designs, but viewing all proposals in light of their function and interaction with public policy could help parties think through what they want to do and provide a framework for calibrating the pluses and minuses of proposed designs. The four general functions proposed market reforms could serve (again, not mutually exclusive) are;

1. Replace legislative mandates and state programs with market based procurement.
2. Supplement or add to existing incentives in legislation to increase the amount of renewables beyond legislative mandates.
3. Assist in the collection of money and the allocation of cost for state mandates.
4. Remove Market Features that make public policy more difficult or costly to achieve.

There is also a fifth function that is not directly related to advancing renewable policies per se and may in some instances interfere with the functionalities above; i.e. purely defensive reforms designed to protect price formation and encourage continued, non-public investment in needed or desired non-renewable resources or infrastructure. I leave this last off the list for now because I do not think it was the main point of the IMAPP process. By that I mean, I presume public officials were looking for more out of this than a successful defense of price formation for non-renewable resources. Such protections may become necessary to keep the lights on, but it doesn't necessarily make renewable expansion easier or cheaper, at least not directly.

The four functionalities above should be useful in analyzing and evaluating proposals, even if the proposals are not *intended* by their proponents to function in one of the four ways listed. For instance, a Carbon adder regime may be suggested as a way to "eventually" replace individual state mandates or procurements and that may be its intended effect. But in the interim, in the absence of immediate repeal of state laws, it is either an additive incentive designed (intentionally or otherwise) to get more renewables in a context where the states already are in disagreement about how much and what to buy, or if it isn't getting more built, it is either wasted or serves the function of collecting money in the market (functionality 3) to offset the costs of bilateral contracts. Thus, thinking through each proposal in terms of what it will do under the four functionalities and deciding whether we are happy with what it will do, or can design it in a way that gets us happy, is the minimum analysis needed to guide design. If the states could identify which functionalities they are looking for¹ we could have a better and more informed discussion about whether there is a practical design to get there and develop a roadmap for the pot holes we want any design to avoid along the way. By framing each proposal in terms of how it will function in both the short and longer term, we might even develop a sequencing roadmap as to what we should get done first or how we could ramp in market incentives so as not to duplicate legislative ones.

¹ For instance; do we want additional incentives beyond current state policy for renewables essentially "legislated" by NEPOOL or FERC? And if not, how do we build a design that avoids that?

Below I offer some discussion of questions that I think arise with respect to the four functionalities. It is difficult not to have this sound argumentative, and I understand that every framework for analysis reflects the priorities of the author. But it is difficult to see how we can reasonably design something without examining closely how it will function and what it will do, in this case specifically in relation to public policies favoring renewables, or, as NESCOE and others have noted, the broader range of economic and R&D legislative objectives.

1. Replacing Legislative Mandates:

- a. It is not reasonable to assume that, *in the short term*, legislators will repeal existing legislation and rely on the market. That means that at least in the short term, any market reform will work in conjunction with or additively too legislatively driven procurement. That is properly analyzed under 2 or 3 below.
- b. Assuming, however, that our goal (or at least one of them) is to design something that can replace or reduce the need for legislative mandates in preference to reliance on a regional market, clearing price type of mechanism in either the energy or capacity market, what is the target procurement we are trying to replace?
 - Specific resources and types in particular locations?
 - A specific number of clean energy KWHs (is current legislation reducible to this?)
 - A single regional or six individual state procurement targets?
 - Other.

Set aside for a moment the logistical problems of trying to design a regional procurement product or mechanism that would satisfy any of the (*) items above, WHAT IS IT THE STATES WANT ON THAT LIST? Again, we do not need specific amounts at this stage, just the **structure** of procurement targets if and when they are ever established. If the states cannot identify a specific structure of the form above, it will be difficult to quantify not only how much to procure but also what to procure.

If, on the other hand, the states would support market reforms in the vague hope (I do not thereby imply such hopes are unreasonable, only that they are not precisely quantified) that added incentives in the market will eventually persuade state legislatures that they don't need to continue out of market procurement, then our design questions need to focus on functionalities 2 and 3 below and include some risk adjustment for the unpredictability of legislatures. The States would need to provide some input on how much additionality and/or potential duplication or expansion of incentives they are willing to expose consumers to in order, essentially, to incent legislatures to rely on the market instead of mandates. A carbon adder could reasonably be calculated to meet an agreed upon level of incentive with some analysis under 2 and 3 below. None of this is an exact science. It is not necessarily unreasonable to put general incentives in

place to drive desired outcomes even for largely irrational activities like legislation. But we do need to decide how much we want to spend on that and the best way to structure it.

2. Supplemental or Additional Incentives.

- a. It is inevitable that any reform we institute will operate in conjunction with existing legislative mandates, at least in the short term. I will try to separate considerations of additionality here from the issues in 3 where a design might just be a way of collecting the money for state mandates without adding to the incentives.

If, for whatever period of time, market reforms exact \$\$ from consumers to promote renewable expansion in addition to the \$\$ already exacted by state policies that require them to pay bilaterally for contracts, then,

- What level of additional investment should the incentives target?
 - Should they target a regional procurement amount or state by state targets?
 - Should it target only specific resource types in particular locations or can the states agree to a simple zero carbon objective?
 - Other.
- b. the above list is not exhaustive, but without some parameters like this it will be difficult to design a particular procurement mechanism or to judge the level of duplication (are we paying people simply to do what ratepayers have already paid them to do bilaterally?) or incrementalism (how much more did we get for our money than what we would have gotten bilaterally under state procurement?). But assuming (as everyone seems to, though, IMHO rather blithely) that we can accurately assign and allocate costs among states to everyone's satisfaction, WHAT IS IT THE STATES WANT FROM THE ABOVE LIST?

Do the states (or some of them) even want (in either the short term or the long term) additional incentives and costs beyond those in current legislative mandates? If so;

- Decided by whom?
 - State legislatures?
 - State PUCs either with or without specific legislative authorization.
 - Agreement among the Six Governors?
 - Some or all of the above in addition to the stake holder process?
 - Some or all of the above and a unilateral 205 filing by the ISO?
 - A unilateral 205 filing by the ISO based on its best estimate of the additional incentives the states collectively but informally (or at least by some mechanism other than those listed above) say they want?

➤ Other?

The above list presents difficult choices but is not meant simply to impose difficulties. Every proposal put forward has responsibly recognized that there must be some mechanism to decide how much to buy and at what cost. The proponents have not ducked these issues, but absent some further input from the States as to how, for instance, to calibrate (or decide how to calibrate) a specific carbon adder, they can make suggestions but cannot settle on a specific procedure or mechanism.

Let us assume, the States are willing to have consumers pay some additional amount on the vague premise (again, I do not imply unreasonable, only not precisely quantified in terms of the * items above) that a general market incentive to encourage renewables is a good thing and within their purview to authorize; proponents still need some input into how much additional incentive this justifies either regionally or state by state. Again, a general incentive for carbon reduction is not unreasonable, even if exactly how much additional reduction or investment we'll get can't be forecast. But I don't know that the states want either NEPOOL or FERC to be the arbiter of how much is enough, which means that to design a product we need to know whether States want additional incentives and if so in what range. If states do not want additional incentives (or want only some minimal amount which may be unavoidable in order to achieve other objectives) then proponents would do well to design a market payment and pricing scheme to be as nearly as possible a facilitation vehicle for collecting and allocating costs and payments in a way that is consistent with state allocation principles. This would come under functionality 3, below.

3. Collecting money and allocating costs.

- a. It might be possible to construct a market clearing mechanism with something like a carbon adder that essentially served as a vehicle to collect from the market the costs (or part of the additional costs) of bilateral contracts doled out as capacity or energy payments to renewable resources. Those resources would then deduct those revenues from amounts paid by consumers under bi-lateral contracts. I presume that any well-structured contract would have that feature anyway (i.e. money from sales in the market should offset bilateral costs to consumers).

In general, this is not an unreasonable construct to try to achieve on a regional basis as long as there is some agreement between the states that such an offset mechanism is not imposing other costs (like a higher clearing price) on those who achieve no benefit from any such write off of bilateral expenses.

Many presenters have assumed that if there were agreement on cost allocation, it would be "easy enough" to allocate costs. In fact, there is agreement on cost allocation: No state can or will pay for any other state's mandate. This has been said to be a "bottom line" principle. Unfortunately, I think this bottom line could make any regional solution very difficult to allocate acceptably. The questions arising under this functionality aren't a function of state intransigence but of the fundamental difficulty of assigning costs and benefits from actions and price effects in an integrated regional market. I run through a few possible scenarios below just to highlight the sorts of questions and challenges this functionality

when it is combined with the states bottom line insistence that no state pay for another state's mandates:

- Let us assume the most simplistic formulation; the amount of added cost to all consumers in the market from a regional higher clearing price is exactly quantifiable and can be allocated back to the holder of the bilateral contract(s).
 1. If the regional cost is higher than the amount the resource gets in the market and pays back to the contract holders (hard to see how it wouldn't be with ALL resources, not just the bilateral ones getting the higher price) then the costs allocated back to the contract holder puts them in a worse position than they would have been without the mechanism. How is that helping?
 2. On the other hand, if we have separate clearing prices or adders only for the bilateral resources that (somehow) don't affect prices for other resources or amounts paid by other consumers (presumably all those adder costs are allocated back only to the bilateral purchaser), then any revenues received from the market are simply coming out of one pocket and going back into the other and we have created a very complicated mechanism that does no more than put everyone in the same position as they would have been just paying for the bilateral contract. How is that helping?
- Let us assume despite the "bottom line" above, the states are willing to tolerate some "leakage" as long as rough justice is preserved. Well, how rough? To take the simplest example of a possible complication, if an out of market contract lowers the capacity clearing price but raises the energy clearing price because of an adder to reflect carbon or anything else, should all states who benefited from the lower capacity price be willing to pay some portion of the higher energy price or do they get to "free ride" on the benefits provided by the holders of the bilateral in the capacity market? What is the "but for" state against which costs and benefits will be calculated?
- b. I feel a regional agreement on targets would be necessary to make market reforms aimed at this third functionality workable. Now, the states, *could* agree to an allocation without getting into the complications above, but that is NOT how I am reading the message with respect to "no state pays for another state's mandates". ***If that message should be tempered or interpreted differently, I think it would be very useful for proponents to know what the degree of tolerance is for departure from precision.*** If it cannot be tempered then I think the notion of setting up a regional mechanism and then reallocating costs and benefits to suit six individual state preferences is likely impractical.

Again, there is no reason for that principle to be absolute and I do not advocate one way or another on whether it should be, but we can't design something on a regional

clearing price basis that will satisfy that principle if it is, in fact, absolute. That is a practical, functional implication of the state's principles that I think people have paid too little attention to.

4. Get Out of the Way.

- a. Even market reforms designed not to hinder or make more expensive the implementation of public policy may incur costs that would be hard to allocate per above. Simple case is the NRG two tier pricing which would allow bilaterally procured renewables to clear. NRG presents a reasonable design approach, but it is not revenue neutral in terms of what existing resources will get paid as opposed to simply opening the gates and letting everything clear with no MOPR. There may be other designs we could adopt that had the same objective of removing market impediments to renewables but might nonetheless stray into other functionalities that we don't want. It is certainly not unreasonable to seek to minimize direct conflicts between market requirements and state policy, but this is a considerably less ambitious goal than presented by many of the current proposals. If this is the main functionality the states are looking for, it would be very useful for participants to know that and adjust their proposals accordingly.