UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

CXA La Paloma, LLC	)	
v.	)	**Docket No. EL18-177-000**
California Independent System Operator Corporation	)	

MOTION FOR LEAVE TO ANSWER AND ANSWER OF NRG

I. MOTION FOR LEAVE TO ANSWER

NRG respectfully requests leave to file this answer in response to various comments and protests in this proceeding. Although the Commission does not generally permit answers to answers under Rule 213(a)(2),[1] the Commission has made exceptions, however, where an answer clarifies the issues or assist in creating a complete record or where the proceeding involves complex issues.[2] In this answer, NRG addresses the jurisdictional questions raised by several protesters and seeks to clarify the appropriate scope of the Commission's inquiry into the justness and reasonableness of the Resource Adequacy ("RA") program jointly administered by the California Public Utilities Commission ("CPUC") and the California Independent System Operator Corporation ("CAISO").

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[1] 18 CFR ¶ 385.213(a)(2) (2014).

[2] *See, e.g. New York Independent System Operator, Inc.*, 121 FERC ¶ 61,112 at P 4 (2007) (answer to protest accepted because it provided information that assisted the Commission in its decision-making process); *PJM Interconnection, L.L.C.*, 119 FERC ¶ 61,318 at P 36 (2007) (accepted answer to answer that "provided information that assisted. . . decision-making process").

II. ANSWER

A. This Proceeding is Not About the Ability of a Bilateral Market Structure to Deliver Just and Reasonable Rates.

Several parties argue that a properly designed bilateral market, implemented by a state regulatory body and backstopped by an independent system operator, can produce just and reasonable results. For example, AEPCO asserts that "[r]ates and prices achieved through bilateral negotiations may not be uniform, but may still be just and reasonable, and not unduly discriminatory."[3] And SWP posits that the bilateral market structure works because, "[e]ach LSE must then procure enough system, local, and flexible resources to meet the targets established under the CAISO Tariff."[4] NCPA likewise suggests that, "CAISO's own bilateral CPM . . . can scarcely be declared per se unreasonable due to its reliance on bilateral contracting."[5]

It is a mistake to view this proceeding as a referendum on bilateral markets versus centralized markets. Instead, it is about whether *this* bilateral RA market, which operates through rules, roles and responsibilities distributed among a number of entities, including the CPUC, California Energy Commission ("CEC") and the CAISO, results in just and reasonable rates. The parties supporting the existing market all take as a given that the CPUC's market is a competitive bilateral market that produces just and reasonable results for both buyers and sellers. The Commission, however, has consistently held that the "facts matter" in evaluating whether the RA program meets the requirements of the Federal Power Act, and the facts here suggest that the RA program is struggling mightily.

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[3] AEPCO Protest at p. 4.

[4] SWP at p. 5.

[5] NCPA at p. 5.

The *MRTU Order* explained that "…to fulfill our statutory responsibilities, [the Commission must] be assured of a workable approach to resource adequacy."[6] Further, that "[a]s a general matter, it is [the Commission's] responsibility to ensure that a workable resource adequacy requirement exists[.]"[7] As the Commission concluded, "[t]his does not mean that we must determine all the elements of such a program in the first instance. Rather, we can, in appropriate circumstances, defer to state and Local Regulatory Authorities to set those requirements. Our primary responsibility is to ensure that a workable program exists and is adhered to by all LSEs."[8]

In NRG's view, one core problem with the RA construct is a lack of common definitions and uniformity of responsibilities. The CAISO may say that all LSEs are responsible for their share of RA capacity, but when the CPUC gets to decide how to measure that compliance for its jurisdictional entities, and federal agencies and other entities outside of the CPUC's jurisdiction get to decide how their compliance is measured, the "workability" of such a patchwork construct comes into question, particularly when viewed in conjunction with the out-of-market capacity procurements that have been issued in the past 12 months.

In the current structure, the CPUC enforces local capacity at one level of granularity (the area level), while CAISO defines and enforces local capacity requirements[9] at a more granular, sub-area level. While the result may be that reliability is maintained, it is maintained in spite of, not because of, the predominant RA market. The Commission recognized that RA requirements must be enforced in a holistic way:[10]

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[6] *California Independent System Operator Corporation*, 116 FERC ¶ 61,274 at P 1117 (2006) ("*MRTU Order*") (emphasis added).

[7] *MRTU Order* at P 1117 (emphasis added).

[8] *MRTU Order* at P 1117 (emphasis added).

[9] The CAISO "enforces" sub-area requirements by using its backstop authority to procure resources that are required to meet sub-area local capacity requirements.

[10] *MRTU Order* at P 1116.

> We further find that meeting the MRTU resource adequacy requirements is a reasonable condition of participation in the CAISO markets. LSEs within the CAISO control area benefit from the reliable supply of energy at just and reasonable prices. As such, it is not unreasonable to require that all LSEs located on the CAISO-controlled grid accept, as a condition of participation in the CAISO markets, those minimum obligations that are necessary to maintain a reliable supply of energy at just and reasonable rates, and to ensure that one LSE cannot "lean on" the others to the detriment of their customers and grid reliability as a whole. Thus, we are requiring, as a condition of participation in the CAISO, that each LSE within the CAISO-controlled grid maintain adequate resources. In order for the CAISO-controlled grid to function fairly and effectively, resource adequacy requirements must be borne by all LSEs, not just a few.

The need for a holistic approach does not apply just to LSE RA procurement targets; it applies to the nature of the RA product itself. The CAISO, in fact, recognizes that the rules for determining the RA capacity value of solar resources inflate the determined capacity values.[11] It follows directly, then, that if CAISO does not have any confidence in the RA value they are getting from one MW of certain supply resources, that it cannot accurately know whether they have the MWs needed to reliably operate the system. These are core issues unlinked from the question of whether there is a centralized auction, a residual auction, or balanced procurement. "How much of what, where" is central to any market design, and CAISO has ducked that core question for years.

Moreover, the Commission spelled out the consequences of what would happen if the Commission determined that the RA construct was not workable. Specifically, the Commission explained that:

> 1114. In addition, resource adequacy plays an important role in addressing whether Commission-jurisdictional wholesale prices reflect the exercise of market power or the scarcity of supply. In particular, we are approving bid caps for the markets operated pursuant to the MRTU Tariff. These bid caps are premised on the notion that bids above these levels may not reflect true scarcity pricing, but rather the exercise of market power or abuse that results in rates that are not just and reasonable. This premise is only valid, however, if there is some mechanism - other

[11] *See* California Independent System Operator Corporation, Track 2 Testimony of Karl Meeusen, submitted July 10, 2018 in CPUC Rulemaking R.17-09-020. This testimony is available at: http://www.caiso.com/Documents/Jul10_2018_RAProceedingTrack2Testimony-Chapter5-ELCC_ProposalNo4_R17-09-020.pdf.

> than energy price increases - to encourage the construction of new generation where and when needed. Consequently, in the absence of a workable resource adequacy program, it would be difficult for us to approve such bid caps. Without a workable program, the bid caps would simply inhibit new supply, and thereby harm customers, rather than protecting customers from the exercise of market power or abuse.

If La Paloma is correct that the RA market is not just and reasonable, the Commission must consider a wide array of potential remedies to ensure rates that comply with the statutory requirements. As the Commission stated, it "can fulfill our jurisdictional responsibilities while also respecting the states' traditional role in this area. As a general matter, it is our responsibility to ensure that a workable resource adequacy requirement exists in a market such as that operated by the CAISO. This does not mean that we must determine all the elements of such a program in the first instance. Rather, we can, in appropriate circumstances, defer to state and Local Regulatory Authorities to set those requirements. Our primary responsibility is to ensure that a workable program exists and is adhered to by all LSEs."[12]

B. Evidence Suggests that the RA Market is No Longer Workable.

Recent events have undermined the theory that the existing RA program is a competitive bilateral market designed to allow parties to contract at competitive prices. The question properly before the Commission is whether the recent spate of out-of-market procurements establish a *prima facia* case that the RA market is no longer "workable." Attempts by the CPUC and CAISO to argue that the market distortions associated with the out-of-market actions as "small" are unavailable.[13] The evidentiary record clearly demonstrates that the CAISO is exercising its backstop authority to remedy fundamental resource adequacy shortfalls at an increasing rate.

As NRG noted, the number of *megawatts* procured under the CAISO's emergency authority may be modest, but the total amount of capacity associated with the affected resources amounts to

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[12] *MRTU Order* at p. 1117.

[13] CPUC at p. 16.

over 10% of the RA capacity requirement. Put another way, the current RA rules are allowing units that should be price-forming units to escape the competitive supply stack. The flaws have nothing to do with the bilateral market structure *per se*, but are critical flaws in the RA program as it currently exists.

Several parties argue that bilateral market results established by a state regulator should be considered *per se* just and reasonable. For example, the Public Interest Organizations assert that "La Paloma fails to identify any objective measures by which the resource adequacy programs are failing to meet the needs of the regional grid."[14] The artificial removal of load from the RA supply stack necessarily has a corrosive impact on contracting opportunities for other RA units. However, the clear evidence is that out-of-market procurements have severely undermined the competitive dynamics relied upon by the Commission when it first approved the RA program as meeting the requirements of the Federal Power Act. This case is not, and never has been about, whether bilateral markets are inherently flawed or whether state resource adequacy structures are *per se* invalid.

Likewise, NCPA gamely tries to suggest that the recent spate of RMR agreements are not evidence of a flawed market, suggesting "that RA markets—whether bilateral markets or centralized auctions—cannot always procure resources with all the necessary operating characteristics that are needed for reliable grid operations. CAISO's RA market—just like the Eastern RTOs' capacity markets—is not designed to specifically procure resources that can provide particular operating characteristics, such as local voltage support, blackstart capability, and others."[15] Indeed, several of the local sub-area capacity requirements (Moorpark, Eastern LA

[14] Public Interest Organizations at p. 7.

[15] NCPA at p. 8. NCPA cites the CAISO's designation of "the Feather River Energy Center as an RMR unit because it is effective in addressing voltage issues in the [local] area by absorbing reactive power from the

Basin) are defined by reactive power need, which can often only be met by capacity located within the sub-area. NRG agrees that the RA program is not designed to, and does not procure, blackstart capability, which serves a specialized function that becomes necessary only rarely when the reliability of the bulk power system under the CAISO's operational control has been fatally compromised. However, the RA program is designed to identify and procure the capacity intended to ensure steady-state reliability, including adequate reactive power support.

C. Jurisdictional Concerns are Misplaced.

Several parties suggest that the Commission lacks the jurisdiction to act in this case, no matter how egregiously unfair (i.e., unjust, unreasonable, or unduly discriminatory) the RA system is. For example, APPA asserts that "[u]nder 201 of the FPA, the Commission's jurisdiction generally does not extend to facilities used for the generation of electric energy, and, as the Supreme Court has observed, need for new power facilities, their economic feasibility, and rates and services, are areas that have been characteristically governed by the States."[16] The CPUC likewise asserts that 201(b) "provides that States retain their traditional jurisdiction over generation and distribution facilities and the services and rates of retail electric utilities, and FERC has jurisdiction over wholesale sales and transmission service, rates, and facilities."[17]

As support for this proposition, the CPUC cites[18] to the statement in *Hughes v. Talen Energy Marketing*, ____ U.S. _____; 136 S. Ct. 1288, 1292, 194 L. Ed. 2d 414, 420 (2016) ("Talen") that "[t]he States' reserved authority includes control over in-state 'facilities used for the generation of electric energy. § 824(b)(1)' . . . 'Need for new power facilities, their economic feasibility, and rates

system." (citations omitted). Unfortunately, the designation of Feather River for voltage support is an exception to the main use of the CAISO's backstop procurement authority.

[16] APPA at p. 5 (citations omitted).

[17] CPUC at p. 25.

[18] CPUC at p. 25.

and services are areas that have been characteristically governed by the States.'" *Talen*, of course, invalidated a state law that purported to subsidize new generation resources in a manner that "sets an interstate wholesale rate, contravening the FPA's division of authority between state and federal regulators."[19] This preemption exists because the FPA allocates to FERC exclusive jurisdiction over "rates and charges . . . received . . . for or in connection with" interstate wholesale sales.[20] The Supreme Court specifically found that a noble purpose does not change the jurisdictional calculus: "But States may not seek to achieve ends, however legitimate, through regulatory means that intrude on FERC's authority over interstate wholesale rates[.]"[21]

1. <u>The Commission Has Ample Legal Authority to Address the Impending Failure of the RA Program.</u>

Talen is instructive to rebutting the claim that the Commission has no jurisdiction over the RA program. The Supreme Court required that "[a] State must rather give effect to Congress' desire to give FERC plenary authority over interstate wholesale rates, and to ensure that the States do not interfere with this authority.'" There is a long line of cases explaining that capacity is indeed an interstate wholesale rate subject to the Commission's exclusive jurisdiction. "Capacity costs are a large component of wholesale rates…" *Mississippi Industries v. FERC*, 808 F.2d 1525, vacated in part on other grounds, 822 F.2d 1104 (D.C. Cir. 1987). In *Municipalities of Groton v. FERC*, 587 F.2d 1296 (D.C. Cir. 1978), the Court upheld FERC's right to levy deficiency charges against utilities for the failure to purchase sufficient capacity. "Where capacity decisions about an interconnected bulk power system affect FERC-jurisdictional transmission rates for that system

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[19] *Talen* at p. 12. Note that despite the superficial similarities between Maryland's attempt to subsidize new generation at a rate different than the PJM rate, California's Long-Term Procurement Program does not suffer from the "fatal defect" because in *Talen*, the Commission "approved the PJM capacity auction as the <u>sole</u> rate setting mechanism for sales of capacity to PJM[.]" *Talen* at p. 15 (emphasis added). That same dynamic does not exist in California.

[20] *Talen* at p 12.

[21] *Talen* at p. 13.

without directly implicating generation facilities, they come within the Commission's authority." Indeed, this is exactly what the CAISO currently does with its various backstop procurement programs: set a charge against utilities when they fail to procure the necessary reliability services rather than create a compensatory market environment.

Notably, the various courts that have considered this issue concluded that establishing deficiency charges, such as those associated with the CPM, does not constitute the type of "direct regulation over generation facilities" prohibited by the Federal Power Act. Instead, the Commission's jurisdiction arises from its inherent ability to regulate the *price of capacity*. "In current market contexts, constructing new generation facilities in response to a higher ICR may even feel like an imperative. But petitioners have posited no source for that feeling other than internalization of the true costs of the alternatives, which is not only a requirement for efficient market outcomes, but, again, something the Commission may concededly pursue." See also *Me. Pub. Utils. Comm'n v. FERC*, 520 F.3d 464 (D.C. Cir. 2008) (upholding creation of a centralized capacity market). As evidence, the Court noted that States retain authority over citing and licensing:

> State 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.

"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." "[T]he purpose behind the deficiency charge" was "to motivate participants to develop sufficient capacity to meet their load requirements." Indeed, the court specifically rejected the arguments of the Connecticut Department of Public Utility Control that requiring utilities to contract with generation resources sufficient to meet Installed Reserve Margin

"… represent[s] the kind of direct regulation of generation facilities plainly forbidden by [FPA] section 201." And it 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 that charge."

APPA likewise unsuccessfully tries to distinguish the controlling precedent of *Connecticut DPUC* by suggesting that "La Paloma is asking the Commission to directly interfere in California's resource adequacy and resource mix policies in a manner that would go well beyond the situation in Connecticut DPUC and would improperly intrude on California's authority over generation facilities in the state." Even under the most drastic federally imposed market, California retains 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."[22] Regulators in California *absolutely* retain the right to determine each of these factors and there is no inconsistency between the inherent right of the state to impose environmental or other rules, on the one hand, and a federally-overseen capacity market structure.

Finally, the Court explained in one of the pithier descriptions of the Commission's jurisdiction that "… even 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**." *Connecticut Department of Public Utility Control v. FERC*, 569 F.3d 477 (D.C. Cir. 2009) (*cert. denied* in 130 S. Ct. 1051) (citing *Municipalities of Groton*). The same is true in California. The very existence of the various capacity backstops at the CAISO level is definitive evidence that the

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[22] *Connecticut DPUC* at ---.

Commission has already entered into California RA procurement waters. The logical extension is: if you own it, you have the responsibility for fixing it.

2. The Commission has Already Settled the Jurisdictional Question.

The Commission extensively addressed jurisdictional issues in 2006 in its initial MRTU tariff order.[23] The Commission acknowledged "the complex jurisdictional concerns raised by commenters in the MRTU proceeding and respects the traditional role of states and local entities over resource adequacy."[24] The Commission explained that its "goal is to appropriately recognize state and local jurisdiction over resource adequacy while at the same time fulfilling our statutory mandate under the FPA to ensure that the rates, terms and conditions of jurisdictional sales of electric energy and transmission in CAISO markets are just, reasonable and not unduly discriminatory or preferential."[25]

In addressing the joint federalism issues, the Commission explained that "[m]any of the objections to CAISO's resource adequacy provisions appear to be premised on the idea that, because resource adequacy requirements have not played a major role in this Commission's review of rate matters in the past, they should not play any role now." The Commission clarified that "… where an interconnected transmission system is operated on regional basis as part of an organized market for electricity, as in California, all users of the system are interdependent, particularly with respect to reliability, i.e., one participant's reliability decisions can impact the reliability of service available to other participants and the related costs the other participants must bear."[26] The Commission concluded that it "must act to ensure that rates for jurisdictional services provided in such an

[23] *California Independent System Operator Corporation*, 116 FERC ¶ 61,274 at P 1112-1113 (2006).

[24] *MRTU Order* at p. 1112.

[25] *MRTU Order* at p. 1112.

[26] *MRTU Order* at p. 1113.

interconnected system remain just and reasonable and not unduly discriminatory or preferential pursuant to sections 205 and 206 of the FPA. We find that, in situations where one party's resource adequacy decisions can cause adverse reliability and costs impacts on other participants in a regionally operated system, <u>it is appropriate for us to consider resource adequacy in determining whether rates remain just and reasonable and not unduly discriminatory</u>."[27]

D. CPUC Efforts to Reform the RA Construct can Continue in Parallel with Commission Action.

Several parties suggest that the Commission should await the outcome of the CPUC's RA "Track 2" reform in D.18-06-030 before taking action in this docket.[28] Unilateral disarmament, however, rarely leads to the right action.[29] Should the CPUC address the flaws in the existing RA program (or something more radical, such as the adoption of a centralized forward RA market), the Commission can revisit its approach. However, there is no doubt that "where one party's resource adequacy decisions can cause adverse reliability and costs impacts on other participants in a regionally operated system, it is appropriate for us to consider resource adequacy in determining whether rates remain just and reasonable and not unduly discriminatory."[30] Moreover, the CPUC recently delayed the next stage of the Track 2 proceeding, and there is absolutely no certainty that the CPUC will reform the RA process.

III. CONCLUSION

For the reasons set forth above and in NRG's initial comments, we renew our request that the Commission carefully examine whether the RA construct remains in compliance with the

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[27] *MRTU Order* at p. 1113 (emphasis added).

[28] *See, e.g.*, CMUA at p. 8; Public Interest Organizations at p. 11.

[29] As President Ronald Reagan famously said, "Trust but Verify."

[30] *MRTU Order* at P 1113.

Federal Power Act given the rapid increase in out-of-market actions taken by the CAISO to ensure resource adequacy.

Respectfully Submitted,

/s/

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September 17, 2018

Certificate Of Service

I hereby certify that I have served a copy of the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Princeton, New Jersey this 17th day of September, 2018.

/s/ *Maria DeLuca*