

FERC ISSUES POLICY STATEMENT ON COST RECOVERY FOR ELECTRIC STORAGE RESOURCES, BUT THE DEVIL WILL BE IN THE “IMPLEMENTATION DETAILS”

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Energy Alert

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Last week, the Federal Energy Regulatory Commission ("FERC" or the "Commission") issued a Policy Statement to provide guidance for electric storage resource owners and operators that may seek to receive cost-based rate recovery for certain services, as well as market-based revenues for other services.[1] The Policy Statement explains that an electric storage resource may provide transmission or grid support services at a cost-based rate, while also participating in the wholesale energy markets administered by a regional transmission organization ("RTO") or independent system operator ("ISO") and earning market-based revenues. As described below, the Policy Statement eliminates some uncertainty created by prior FERC precedent, which limited electric storage resources' ability simultaneously to provide transmission or grid support services at cost-based rates and also participate in the wholesale markets.

However, the path forward for electric storage resources to "stack" payment streams and recover costs through both cost-based and market-based rates will not be without obstacles. The Policy Statement acknowledges that "implementation details" will need to be addressed. Additionally, FERC Commissioner Cheryl LaFleur dissented, disagreeing with the Policy Statement's broad statements that electric storage resources' ability to recovery costs through both cost-based and market-based rates will not adversely impact other market competitors. Commissioner LaFleur also disagreed with the decision to address the issue of electric storage resources' ability to recover costs through both cost-based and market-based rates in a proceeding separate from the pending Notice of Proposed Rulemaking on electric storage's participation in RTO/ISO markets ("Electric Storage NOPR").[2] Thus, while the Policy Statement removes some uncertainty, electric storage resources will likely still have to grapple with cost recovery, competition, and other issues on a case-by-case basis.

This alert provides background on the Commission's prior precedent related to electric storage resources and cost-based recovery, as well as the Commission's recent efforts in several open proceedings to address potential barriers to the further development of electric storage resources. Provided below is a summary of the Commission's Policy Statement, as well as an overview of open questions and unresolved issues that are intertwined with issues presented in the Commission's Electric Storage NOPR and other recent orders.

BACKGROUND

Prior FERC Precedent

Prior to the Policy Statement, the Commission's policy on the ability of electric storage resources to recover costs through cost-based and market-based rates has been guided by two primary decisions: *Nevada Hydro*, issued in 2008 and *Western Grid*, issued in 2010.[3] In *Nevada Hydro*, the developer of a proposed pumped hydro storage facility requested that the facility be treated as a transmission facility under the control of the California Independent System Operator (CAISO) and that the facility's costs be recovered through the CAISO's Transmission Access Charge. The Commission denied the requests, finding that it would be inappropriate for CAISO to take operational control of the facility, and thus, the facility should not be included in the Transmission Access Charge. The Commission agreed with intervenors' concerns about potential adverse market impacts and that CAISO's operational control of the pumped hydro storage would compromise CAISO's independence, transforming it into an energy market participant responsible for deciding when to charge (*i.e.*, pump) and discharge (*i.e.*, generate) the facility.

In *Western Grid*, the Commission accepted a battery storage developer's proposal to provide transmission services for voltage support and thermal overload situations at cost-based rates. However, unlike the developer in *Nevada Hydro*, the battery storage developer explained that it would manage the state of charge for the facility, eliminating concerns about CAISO's independence. The battery storage developer also agreed to credit any incidental net revenues from managing the state of charge in its cost-based transmission rate and committed to forego any sales into the wholesale energy market. While both the *Nevada Hydro* and *Western Grid* decisions were grounded in the particular facts specific to each proposed electric storage facility, the decisions combined to create uncertainty as to whether and how a particular electric storage facility could provide services at both cost-based and market-based rates.

FERC Proceedings Related to Electric Storage

In the several years since these two decisions, electric storage technology has advanced, costs have fallen, and innovation and investment have increased. In 2016, the Commission began to take notice of potential regulatory barriers and barriers to revenue recognition that may be impeding the development of electric storage resources. For example, in April 2016, Commission staff issued data requests and a request for comments seeking information about RTO/ISO market rules that affect the participation of electric storage resources. That request and the responses and comments received ultimately lead to the Commission's issuance of the Electric Storage NOPR on November 17, 2016. FERC also issued two other NOPRs in December 2016 that, while not focused exclusively on electric storage resources, involve proposals to reform interconnection procedures for electric storage resources[4] and improve price formation in RTO/ISO markets to better reflect the value of fast-start resources, such as electric storage resources.[5]

On a parallel track, the Commission announced in September 2016 that it would hold a technical conference to explore potential models for cost recovery for electric storage resources utilized as transmission assets or providing grid support services, while also selling energy, capacity or ancillary services at wholesale. The technical conference was held on November 9, 2016, and following the technical conference interested parties were invited to submit comments. Over 30 parties submitted comments, with several suggesting that the Commission issue a policy statement to resolve the confusion and uncertainty created by the Commission's prior

precedent in *Nevada Hydro* and *Western Grid*. That technical conference and the comments filed in response resulted in the issuance of last week's Policy Statement.

SUMMARY OF POLICY STATEMENT

The Policy Statement focuses on three issues raised by commenters in response to the *Nevada Hydro* and *Western Grid* precedent and the technical conference: (1) the potential for double-recovery of costs to the detriment of cost-based ratepayers if an electric storage resource provides services at both cost-based and market-based rates; (2) the potential for an electric storage resource's combined cost-based and market-based rate recovery to cause adverse market impacts, such as inappropriate suppression of competitive prices, to the detriment of other market participants that do not receive cost-based rate recovery; and (3) the level of control an RTO/ISO may have over the operation of an electric storage resource without jeopardizing the RTO/ISO's independence.

Avoiding Double Recovery of Costs

In the Policy Statement, the Commission acknowledges that one possible solution to address double-recovery concerns is to create a mechanism that would provide a credit or offset to ratepayers paying for a cost-based service based on the market-based revenues that an electric storage resource receives. The Commission explained that the operation of such a crediting mechanism could vary depending on whether an electric storage resource seeks to recover its full costs through cost-based rates. For example, if the electric storage resource elects to recover only a portion of its costs through cost-based rates, the Commission suggests that a partial crediting of market revenues may be appropriate. The Commission also explained that there may be other approaches to address double-recovery concerns.

Minimizing Adverse Market Impacts

Several technical conference commenters raised concerns that if electric storage resources are able to receive cost-based rate recovery, their concurrent participation in the wholesale electricity markets could undermine competition and suppress market prices to the detriment of competitors that do not have the ability to recover costs outside of market revenues. In the Policy Statement, the Commission explained that it does not share such concerns and was not persuaded that allowing electric storage resources to recover costs through cost-based and market-based rates for separate services would adversely impact other market competitors.

The Commission pointed out several examples in which RTO/ISO market participants are compensated for services at cost-based rates, while also making market-based rate sales into the wholesale electric markets. For example, generators may be paid a cost-based rate for reactive supply, while also making sales of energy, capacity, and ancillary services at market-based rates. Vertically integrated public utilities can also recover some or all of their costs through cost-based retail rates or rates for captive wholesale requirements customers, but also make market-based sales. The Commission explained that concerns about adverse market impacts and suppression of market clearing prices could be addressed through a crediting mechanism or other approach to prevent double-recovery of costs.

RTO/ISO Independence

In *Nevada Hydro*, the Commission concluded that it would not be appropriate for CAISO to assume "any level of operational control" over the proposed pumped storage facility.[6] This precedent created significant uncertainty about how the operation of an electric storage resource could be coordinated to switch between transmission, grid support, or reliability services provided at a cost-based rate and energy, capacity, and ancillary service sales compensated at a market-based rate.

In the Policy Statement, the Commission recognized that if an electric storage resource is committed to provide transmission or grid support services for reliability needs at a cost-based rate, that service would need to take priority over the electric storage resource's market-based rate activity. However, the Commission explained that in situations where the need for the cost-based service may be sufficiently predictable as to size and timing, it may be possible for an electric storage resource to provide other market-based services while still managing its obligation to provide the required cost-based service. The Commission clarified that the electric storage resource's provision of market-based services should be under the control of the resource owner or operator, but that RTOs/ISOs could rely on offer parameters to dispatch electric storage resources through their existing market clearing processes. The Commission suggested that performance penalties could be used to hold electric storage resources accountable for transmission, grid support, or other reliability services provided at cost-based rates and to ensure the electric storage resource manages its charge to maintain availability.

THE DEVIL IS IN THE "IMPLEMENTATION DETAILS"

In the opening paragraph of the Policy Statement, the Commission recognizes that even though the Policy Statement is intended to clarify prior precedent and open opportunities for cost-based and market-based rate recovery, there will be "implementation details" to be addressed, including details related to the issues of double-recovery, adverse market impacts, and RTO/ISO independence that the Policy Statement specifically addresses. In her dissent, Commissioner LaFleur stated that the Policy Statement "leaves far more than just 'implementation details' to be worked out", raising specific concerns about the Policy Statement's broad dismissal of competition concerns.

Accordingly, while the Policy Statement opens the door to new and creative rate proposals for cost-based rate recovery for electric storage resources, parties will need to think carefully about how the particular characteristics of a rate proposal and the proposed operation of the electric storage resource justify the proposed cost recovery mechanisms, address competition concerns that intervenors may raise, and ensure RTO/ISO independence. For example, coordination with RTOs, ISOs, and their market monitors may be especially important to ensure their concerns are adequately addressed and do not derail the electric storage resource's proposal.

Electric storage resources should also be mindful of the intersections between the Policy Statement and other open NOPR proceedings involving electric storage to ensure market rules and procedures proposed in those proceedings support the ability to receive cost-based and market-based recovery and do not work at cross-purposes. Some examples of possible intersections are outlined below.

- The Electric Storage NOPR proposes that RTOs/ISOs create "participation models" for electric storage resources that incorporate bidding parameters reflective of the physical and operational characteristics of electric storage resources. If electric storage resources are to take advantage of cost-based recovery

opportunities, the bidding parameters proposed in response to the Electric Storage NOPR will need to work together with rules applicable to electric storage resources' provision of cost-based services and the priority use of electric storage resources for transmission and grid support services.

- In the Interconnection Procedures NOPR, the Commission "proposes to require that transmission providers evaluate their methods for modeling electric storage resources for interconnection studies [and] identify whether their current modeling and study practices adequately and efficiently account for the operational characteristics of electric storage resources." [7] In this context, interested parties may consider whether RTO/ISO modeling practices adequately and efficiently account for potential cost-based transmission or grid support services that an electric storage resource may provide concurrently with its wholesale market activity.

While the Policy Statement and FERC's other energy storage initiatives aim to eliminate some regulatory underbrush that may be obstructing recognition of electric storage resources' contributions to transmission and grid support, these initiatives also introduce a new set of novel and complex issues to be sorted out.

NOTES:

[1] *Utilization of Electric Storage Resources for Multiple Services When Receiving Cost-Based Rate Recovery*, 158 FERC ¶ 61,051 (2017).

[2] See our prior blog post for a summary of the Commission's pending Electric Storage NOPR linked here. Comments on the Electric Storage NOPR are due February 13, 2017.

[3] *Nev. Hydro Co., Inc.*, 122 FERC ¶ 61,272 (2008); *Western Grid Dev., LLC*, 130 FERC ¶ 61,056, *reh'g denied*, 133 FERC ¶ 61,029 (2010).

[4] *Reforms of Generator Interconnection Procedures and Agreements*, 157 FERC ¶ 61,212 (2016) ("Interconnection Procedures NOPR"). Comments on this NOPR are due March 14, 2017.

[5] *Fast-Start Pricing in Markets Operated Regional Transmission Organizations and Independent System Operators*, 157 ¶ 61,213 (2016). Comments on this NOPR are due February 28, 2017.

[6] *Nevada Hydro*, 122 FERC ¶ 61,272 at P 82 (*emphasis added*).

[7] Interconnection Procedures NOPR, 157 FERC ¶ 61,212 at P 229.

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