

A RESPONSE TO PROFESSOR MORMANN'S
CLEAN ENERGY FEDERALISM

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Professor Felix Mormann's work to differentiate clean energy federalism from environmental federalism in his paper, "Clean Energy Federalism," is important.¹ These two theoretical frameworks are similar, but clean energy federalism incorporates a nuanced understanding of the energy system and renewable resources. Professor Mormann illustrates the difference by analyzing a proposed subsidy scheme that aims to reduce the cost of renewable electricity by reducing risk to investors.² The "risk premium" demanded by investors increases the cost of renewable energy projects, which increases the cost of the energy generated by those projects. The proposed program combines a national-level Renewable Portfolio Standard (RPS) with state-level Feed-In Tariff (FIT) and makes several improvements over the current system of state-level RPS and federal-level renewable tax credits.³ Professor Mormann's recommended national RPS creates a larger, more liquid market for the Renewable Energy Credits (RECs) used to comply with the RPS that could allow states/utilities to comply at a lower cost. He suggests that a FIT program would reduce financing costs for renewables projects by ensuring a fixed price and a buyer, which could drive down the cost of energy from those projects.⁴ Furthermore, this scheme better aligns renewables incentives with the interstate flow of electric power and the geographic heterogeneity of renewable resources.⁵

Professor Mormann argues convincingly in Section III.A that a FIT reduces financing costs for new renewable generation projects by shifting development finance risks from project developers and investors to utilities and electricity ratepayers.⁶ The primary risk is in setting the FIT higher than necessary to incentivize development, which delivers windfall profits to renewable developers paid for by utilities and their ratepayers. He offers two ways to allocate these risks between utilities and ratepayers. The first is a "cost-neutral" option that passes the costs and risks of FITs and RECs through to ratepayers.⁷ State public utilities commissions will offer some protection to ratepayers by requiring utilities to justify that those costs are "reasonable" before

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1. Felix Mormann, *Clean Energy Federalism*, 67 FLA. L. REV. 1621 (2015).
2. *See id.* at 1660–62.
3. *See id.* at 1628.
4. *See id.* at 1632.
5. *See id.* at 1633.
6. *See id.* at 1659–65.
7. *See id.* at 1665–67.

incorporating them into retail.⁸ The second option is a “profit-oriented” option that allows the utility to sell excess RECs for profit and to reduce retail rates.⁹

We agree with Professor Mormann’s assessment that utilities “have substantial experience with these types of markets and possess the resources and expertise to navigate them successfully.”¹⁰ However, utilities may not always be able to use REC markets to compensate for overly-generous FITs. First, utilities may not have excess RECs to sell even if a FIT is too generous. Some current programs, such as California’s Renewable Auction Mechanism for solar PV,¹¹ limit the number of FITs offered each year.¹² A FIT program can be limited to match the RPS requirement, but that might leave utilities without any RECs to sell. Second, there may not be buyers for excess RECs. Consider a nation-wide flattening or decrease in demand, such the Great Recession of 2008–2009.¹³ In that case, most utilities would need fewer RECs than they forecasted for RPS compliance, so there would be a surplus in the REC market, low prices, and few buyers.

The REC market is also volatile. Demand for RECs is very inelastic in the short run¹⁴ (i.e., change in demand for RECs is insensitive to change in price) because each utility must obtain enough to comply with the RPS at the end of each compliance period.¹⁵ There may be wide swings in REC prices because the supply of RECs fluctuates with weather-dependent renewable generation¹⁶ and because new renewable generators take several years to build.¹⁷ Most current RPS programs reduce the inelasticity of demand by allowing banking and borrowing of REC between years, and partly mitigate the price risk by setting an upper limit on REC price (called an alternative compliance payment).¹⁸

The proposed RPS-FIT scheme is well suited to states with regulated utilities, but it might be difficult to implement in the seventeen states

8. *See id.* at 1638.

9. *See id.* at 1667–71.

10. *See id.* at 1668 (footnote omitted).

11. Jessica Wentz, *Balancing Economic and Environmental Goals in Distributed Generation Procurement: A Critical Analysis of California's Renewable Auction Mechanism (RAM)*, GEO. WASH. J. ENERGY & ENVTL. L. 30, 30 (2014).

12. *Id.* at 33.

13. Kimberly Klaiman, *Total Electricity Sales Fell in 2015 for 5th Time in Past 8 Years*, U.S. ENERGY INFO. ADMIN. (Mar. 14, 2016), <http://www.eia.gov/todayinenergy/detail.cfm?id=25352>.

14. PLATTS, *RENEWABLE ENERGY CERTIFICATES 8* (2012). “Short run” in REC market is the scale of the compliance period, typically one year. *Id.* at 5.

15. *Id.* at 5.

16. *See Mormann, supra* note 1, at 1656.

17. RICHARD P. WALKER & ANDREW SWIFT, *WIND ENERGY ESSENTIALS: SOCIETAL, ECONOMIC, AND ENVIRONMENTAL IMPACTS* 107 (2015).

18. PLATTS, *supra* note 14, at 7.

that offer “retail choice” programs.¹⁹ Consumers in these states can change their electricity provider,²⁰ which means a provider’s customer base may be constantly changing. This makes it very difficult for providers to forecast their future demand for RECs and to sign long-term FIT contracts. Retail-choice states may have to implement some other subsidy structure to incentivize renewable development.

Professor Mormann’s proposed subsidy scheme offers a promising way to reduce the cost of renewable energy. Equally important, it situates renewable subsidies in the theoretical framework of federalism. Professor Mormann argues that the particular features of many clean energy issues require a nuanced understanding of the energy system that environmental law generally lacks. He uses the proposed RPS-FIT scheme as a case study to illustrate how three key principles of environmental federalism (the matching principle, public choice theory, and dynamic federalism) could be adapted to better apply to renewable energy issues. This is an important contribution to developing the theoretical basis of clean energy law.

19. Severin Borenstein & James Bushnell, *The U.S. Electricity Industry After 20 Years of Restructuring* 10 (Energy Institute at Haas, Working Paper No. 252R, 2015).

20. EPA, ENERGY AND ENVIRONMENT GUIDE TO ACTION 7-13 (2015).