

CLEAN ENERGY INCENTIVES: RISK, CAPTURE, AND FEDERALISM

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INTRODUCTION

Professor Felix Mormann’s article *Clean Energy Federalism* provides a compelling framework for effectively incentivizing clean energy development in the United States and for theorizing this field.¹ The article tackles two primary questions that arise in the incentives and innovation debate, including what types of incentives work best—such as renewable portfolio standards (RPSs) or feed-in tariffs (FITs)—and what level of government should formulate and administer these incentives.² As Professor Mormann explains, these are two very different tools that aim toward the same goal of incentivizing the rapid construction of essential low-carbon, low-pollution energy resources.³ An RPS requires that a certain percentage of electricity come from renewable electricity generation and leaves the market to determine who provides which renewable generation, and how much they provide it for.⁴ A FIT, in contrast, does not set a minimum amount of renewable electricity that must be generated.⁵ Rather, it directly incentivizes renewable electricity generation by guaranteeing that certain types of generators may interconnect with a retail utility’s grid and sell electricity to the utility at a rate that is very likely to produce an economic return.⁶

Building from previous literature on the benefits of combining FITs and RPS mechanisms,⁷ Professor Mormann argues for what I call a “pluralistic” approach to incentivizing clean energy. He concludes that a combination of incentives—both the RPS and the FIT—and the governance of these incentives at different levels (such as the federal and state level) might be the most effective incentivization approach, and the most palatable from a federalism perspective.⁸ He also concludes that an

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1. Felix Mormann, *Clean Energy Federalism*, 67 FLA. L. REV. 1621 (2015).

2. *See id.* at 1624–28.

3. *See id.* at 1624.

4. *Id.*; *see* Lincoln L. Davies, *Reconciling Renewable Portfolio Standards and Feed-In Tariffs*, 32 UTAH ENVTL. L. REV. 311, 313 (2012) (introducing and defining the RPS).

5. *See* Davies, *supra* note 4, at 313.

6. *See* Mormann, *supra* note 1, at 1653; *see also* David Grinlinton & LeRoy Paddock, *The Role of Feed-In Tariffs in Supporting the Expansion of Solar Energy Production*, 41 U. TOL. L. REV. 943, 944 (2010) (defining the feed-in-tariff and explaining that it is designed to guarantee a “reasonable economic return” to the electricity producer).

7. *See* Davies, *supra* note 4, at 313 (“With sufficient political will, RPSs and FITs can be harnessed together in a way that should be more effective than using either alone.”).

8. *See* Mormann, *supra* note 1, at 1627, 1647, 1652–58.

RPS might best be federally created and administered,⁹ although noting good reasons for a state-administered RPS, too.¹⁰ Finally, Professor Mormann argues that FITs are best located at the sub-federal (state or local) level.¹¹

The greatest contribution of Professor Mormann's article is its practical and theoretical case for dualistic or pluralistic approaches to incentivizing clean energy. I use "pluralistic" loosely here, and not in its technical political sense,¹² to capture a state of affairs in which diverse policy approaches are used at different governance levels to solve one problem. As Professor Mormann notes, FITs and RPS policies pose different types of risks, and combining these two policies allows for a dilution or mitigation of these risks.¹³ For those of us not as schooled in renewable energy finance as Professor Mormann is, one could view this as being somewhat similar to a portfolio investment approach, in which one spreads and diversifies risks so that a loss at one level can be offset by a win at another.¹⁴ In addition to the importance of combining policy tools to reduce overall risk, one can also diffuse the risk of governments implementing inadequate or inefficient policies to spur clean energy growth. Different levels of government pose different political economy challenges, with the risk of capture arising at each level.¹⁵ Administering different types of incentives at different levels of government increases the chance that the negative aspects of the capture of legislatures and agencies might be overcome at one level, at least. Thus, the article brilliantly advocates for two essential types of pluralism, or at least dualism, by furthering the argument for the use of two different incentive strategies and for anchoring these strategies at different levels of government.

My only quibble with the piece, which is a very minor one, is Professor Mormann's conclusion that FITs should be state-based endeavors.¹⁶ It appears that RPSs and FITs could be either local, state, or federal—or a combination of these, as Professor Mormann notes in the

9. *See id.* at 1621, 1627, 1672.

10. *Id.* at 1647–52.

11. *See id.* at 1653–57.

12. In its technical, political sense, scholars often use the term pluralism as a contrast to republicanism, in which elite, educated experts control a society. A pluralist system instead gives political voice to a diverse array of interests expressing different and often conflicting perspectives. *See, e.g.,* Jonathan R. Macey, Comment, *The Missing Element in the Republic Revival*, 97 *YALE L.J.* 1673, 1675–76 (1988).

13. Mormann, *supra* note 1, at 1657.

14. *Cf.* Mark Rubinstein, *Markowitz's 'Portfolio Selection': A Fifty-Year Retrospective*, *LVII J. FINANCE* 1041 (2002).

15. *See* Mormann, *supra* note 1, at 1672.

16. *See supra* note 11 and accompanying text.

RPS context¹⁷—and could still be quite effective. Provided that these incentives are offered at *different* governance levels, the benefits of diluting risk and the threat of capture seem equal, regardless of which level of government is chosen. Thus, the paper could perhaps be even more agnostic about the proper level of FIT governance while still persuading readers of the importance of multi-level approaches to incentivizing clean energy.

This response begins in Part I by focusing on the importance of pluralism in clean energy innovation that Professor Mormann so cogently captures. Part II then explores why both FITs and RPSs—not just RPSs—seem well-suited to local, state, or federal control, thus perhaps not requiring FITs to become mired in the federalism debate over which level of government should control a particular policy area. Because top-down, federal FITs need not be uniform, there need not be a federal one-size-fits-all approach in this area. And federal officials, particularly if they work with local and state governments, might have superior expertise in terms of identifying effective FITs. Professor Mormann acknowledges that a federal FIT could allow for variation in terms of states having the latitude to issue varied FITs above a federal floor or through waivers.¹⁸ Indeed, this would likely be the most efficient path to take if a federal FIT were implemented. But the federal government could also create different FITs for different states (while working with states to better understand the unique aspects of peak electricity generation, transmission congestion, and distribution challenges within each state), and this possibility, along with the option of a FIT floor or waivers for states, might merit further exploration in future work.

I. THE BENEFITS OF PLURALISTIC CLEAN ENERGY GOVERNANCE

Professor Mormann's account of the risks associated with RPS versus FIT policies provides a compelling foundation for his argument that we should not choose one of these policies over another, but rather integrate them.¹⁹ As his article describes, there are two core risks associated with incentivizing the growth of clean energy generation. The first is regulatory risk, in which a large chunk of society, such as the electricity ratepayer population, ends up paying more than is necessary to incentivize this generation, or generators are paid too little and thus fail to build the desired infrastructure or produce its desired effects, including mitigating climate change and other environmental effects.²⁰ The second is investment risk, in which potential project investors worry about uncertain off-take (the uncertain availability of buyers willing to pay a

17. Mormann, *supra* note 1, at 1627.

18. *Id.* at 1650, 1655.

19. *Id.* at 1628.

20. *See id.* at 1662–63.

certain rate for the electricity), volatile prices, or other market-based problems.²¹

Professor Mormann convincingly explains—even for readers like me whose eyes glaze over at the mention of complicated investment mechanisms—that FITs reduce a variety of investment risks, while RPSs address several regulatory risks. FITs provide a guaranteed off-take (or buyer) because retail utilities must allow access to their local distribution wires and must purchase electricity from clean energy sellers at a price designed to allow these sellers to maintain a successful business in a risk-prone environment.²² But FITs pose regulatory risks because if the guaranteed price is too high, ratepayers overpay to incentivize clean energy, and if it is too low, clean energy infrastructure simply will not be built—or not enough of it will be built.²³ RPS systems erase much of this regulatory risk by simply requiring that a certain amount of electricity come from renewable electricity and then letting the market determine who will generate that electricity and how much they will sell it for.²⁴ As Professor Mormann explains, the invisible hand sorts out supply and demand and typically causes the energy to be provided for a reasonable price;²⁵ the most efficient and competitive renewable generators provide the electricity, and ratepayers are not stuck with unreasonably high rates. But sometimes there is not enough incentive for renewable generators to fill this market, thus posing investment risk. Investors in renewable generation, who are incentivized to invest by an RPS, face the risk of two different types of volatile prices—the price of electricity and the credit that guarantees that a unit of electricity has been generated from a renewable source—and this can raise transaction costs.²⁶ Thus, Professor Mormann’s proposal to combine an RPS and FIT—using either a federal RPS and state/local FIT, or a state RPS and state/local FIT—balances and mitigates risk, both creating markets for green electricity and incentivizing individual generators to fill those markets without imposing unduly high costs on society.

This proposal, along with previous work by Professor Lincoln Davies regarding the important synergies between RPS and FIT policies,²⁷ provides a persuasive account of encouraging the adoption of both types of policies in order to spur more green energy development. As Professor Davies has noted, FITs assure that renewable technologies will be deployed because they guarantee purchases of electricity from renewable

21. *See id.* at 1660–63.

22. *See id.* at 1660–61.

23. *See id.* at 1661–62.

24. *See id.* at 1662–63.

25. *Id.* at 1663.

26. *See id.* at 1664–65.

27. Davies, *supra* note 4.

resources at a set price, and they can also minimize transaction and administrative costs if designed properly.²⁸ RPSs, on the other hand, guarantee that a particular amount of renewables will be deployed.²⁹ And both FIT and RPS policies can ensure technological diversity and can help to minimize the price impacts of renewable energy growth.³⁰

Beyond the case for combining two substantive policies, Professor Mormann provides a similarly convincing governance account, suggesting that placing authority over these incentives at two different levels of government could mitigate the risks of capture.³¹ I agree with his conclusion that the large public choice literature has not yet definitively shown whether inefficient capture of the governmental process—which could sometimes lead to inadequate support for clean energy—is more powerful at the federal, state, or local level.³² And in light of lingering uncertainties about the risk of undue influence of small, well-organized, powerful interest groups in the political process, it makes sense to balance out these risks by expanding and diversifying the levels of government responsible for different clean energy incentive programs. For example, if the federal government set an inadequately ambitious RPS, aggressive state and local FITs could still generate investments that exceed the RPS, thus overcoming weak federal goals.³³

II. TOWARD AGNOSTIC FIT FEDERALISM

While noting the benefits of risk mitigation offered by integrating two types of incentives, and potentially at two different levels of government, Professor Mormann also provides a thorough analysis of whether RPS or FIT programs are better situated at the federal or state level.³⁴ I am fully persuaded by his argument that there is a case for either a federal or state RPS. He notes, for example, that although the RPS addresses a problem of national and international scope and thus might best be federally governed, it also produces distinctly local benefits.³⁵ Further, the fact that so many states have implemented an RPS and experimented with effective RPS approaches, and that utilities cannot easily move among jurisdictions and cause a race to the bottom, might also point to the

28. *See id.* at 351–52.

29. *Id.* at 351.

30. *See id.*

31. *See* Mormann, *supra* note 1, at 1672.

32. *See id.* at 1677–78. For additional discussion of whether capture might be more likely at the local, state, or federal level in the renewable energy context, see Garrick B. Pursley & Hannah J. Wiseman, *Local Energy*, 60 EMORY L.J. 877, 929–30 (2011).

33. Professor Mormann notes that this could occur. *See* Mormann, *supra* note 1, at 1668–69.

34. *See id.* at 1632–52.

35. *Id.* at 1641.

benefits of a state-based RPS.³⁶ But as Professor Mormann also observes, the benefits of a national market for renewable energy credits—which are the “currency” of an RPS program and the units that utilities purchase and trade in order to meet their RPS requirements—are large and, on balance, might suggest a need for federal RPS authority.³⁷

Professor Mormann carefully analyzes the reasons for and against locating FIT programs at the federal, state, and local level, but he is less agnostic about which level of government might be best.³⁸ He focuses on the benefits of governing FITs sub-federally, including, for example, the ability to tailor the FIT to the specific type of renewable technology (in order to correctly set the price and reduce investment risk) and to address localized conditions such as peak demand for electricity and congestion in distribution wires—conditions that might militate in favor of certain technologies being incentivized by a FIT.³⁹ He also notes that because states already set renewable energy purchase requirements under the federal Public Utility Regulatory Policy Act (PURPA) and determine the rates that utilities may use to recover their costs (including the costs of a FIT), state-level FITs fall easily within the existing state regulatory system.⁴⁰

Professor Mormann additionally documents the benefits of a federal FIT and acknowledges the possibility of the federal government setting a federal FIT floor, above which local and state governments could experiment.⁴¹ But more consideration of the potential to harness federal resources in FIT development—not necessarily by placing FIT creation and administration responsibilities at the federal level, but at least by enlisting the federal government in the FIT effort—could be productive. For example, although states can currently tailor FITs to comply with federal renewable energy purchase requirements under PURPA, these states sometimes run into federal hurdles. PURPA requires that utilities pay certain small renewable electricity producers “avoided cost”—the amount that it would have cost the utility to generate its own electricity or purchase it elsewhere.⁴² And the Federal Energy Regulatory Commission, which administers PURPA, has adhered to a relatively broad definition of avoided cost, thus allowing states to set the FIT at a price that fits within this definition.⁴³ But in some cases states have been

36. *Id.* at 1646–47.

37. *Id.* at 1644–45.

38. *Id.* at 1628.

39. *Id.* at 1656–57.

40. *Id.* at 1653.

41. *See id.* at 1655.

42. *See* 16 U.S.C. § 824a-3(d) (2012).

43. *See* S. Cal. Edison Co., Pac. Gas & Elec. Co., and San Diego Gas & Elec. Co., 133 FERC ¶ 61,059 (2010) [hereinafter FERC]; Jim Rossi, *Clean Energy and the Price Preemption*

able to interpret PURPA in a manner that impedes rather than encourages renewable energy growth.⁴⁴ Additionally, for states that want to encourage growth by providing generous FITs, there are limits to which FITs count as “avoided cost.”⁴⁵ The federal government might be able to better tailor a FIT to PURPA’s avoided cost requirements.

Further, although Professor Mormann notes that state-based FITs capture important differences in local conditions,⁴⁶ the federal government could also address these differences. Specifically, the government could write different FITs for different states after consulting with local and state governments regarding unique clean energy needs that arise due to local distribution line congestion, peak electricity demand, and other factors.⁴⁷ Ultimately, it might be more effective and efficient for the government to set a FIT floor as Professor Mormann briefly suggests⁴⁸—thus protecting against potential races to the bottom that might occur despite utilities’ and ratepayers’ limited mobility—and allow states to regulate above this floor based on important state differences. But even within this cooperative federalism approach, the federal government should at least further collaborate with the states in light of its extensive expertise and resources in the clean energy field, and its ability to help states design and measure the effectiveness of their different experiments.⁴⁹

CONCLUSION

In a world of rising seas and ever more powerful storms, *Clean Energy Federalism* provides an essential theoretical and practical path toward cleaner energy. This piece adds a large building block to a small but growing energy federalism literature, providing a concrete and convincing picture of the benefits offered by multi-layered, dynamic governance systems that use several tools to achieve a singular goal. It

Ceiling, 3 SAN DIEGO J. CLIMATE & ENERGY L. 243, 244, 250–51 (2011–2012) (discussing the FERC order).

44. See *Exelon Wind v. Nelson*, 766 F.3d 380, 400 (5th Cir. 2014) (Prado, J., dissenting) (“The effect of the majority’s opinion is to undermine an important federal program that promotes renewable energy.”).

45. See FERC, *supra* note 43; see also Rossi, *supra* note 43, at 244–45, 255 (arguing that PURPA should be viewed as a preemption floor, above which states may include more aggressive renewable energy requirements, rather than a ceiling).

46. See Mormann, *supra* note 1, at 1654–55.

47. Cf. Dave Owen, *Regional Federal Administration*, 63 UCLA L. REV. 58, 60–61, 113, 116 (2016) (noting that the federal government can generate experiments through sub-federal regional offices and that states need not necessarily be the “experiment[ers]”).

48. See *supra* note 41 and accompanying text.

49. See Hannah J. Wiseman, *Regulatory Islands*, 89 N.Y.U. L. REV. 1661, 1695, 1708, 1710–11 (2014) (exploring the important role of the federal government in collecting information on different states’ approaches to a regulatory issue and thus allowing for effective comparison of these approaches).

also jumpstarts the debate as to whether FITs should be federal, state, or local.⁵⁰ While further consideration of the federalism values captured by each of these levels of government in the FIT arena is merited (such as experimentation, the avoidance of races to the bottom, and achievement of the matching principle), Professor Mormann's account of the distinct benefits of local and state governance of FITs is quite persuasive. Achieving efficient progress toward clean energy growth is a critical policy priority, and this article provides the blueprint for this project, both from the perspective of selecting policy tools and considering the level of government that might best wield these tools.

50. See Mormann, *supra* note 1, at 1626–27.