

**BEFORE THE
UNITED STATES HOUSE OF REPRESENTATIVES**

**COMMITTEE ON ENERGY AND COMMERCE,
SUBCOMMITTEE ON ENERGY AND POWER**

**TESTIMONY OF THE HONORABLE TRAVIS KAVULLA
PRESIDENT, NATIONAL ASSOCIATION OF REGULATORY UTILITY
COMMISSIONERS**

**ON BEHALF OF THE
NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS**

ON

**“A Review of EPA’s Regulatory Activity During the Obama Administration: Energy and
Industrial Sectors”**



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Summary of the Testimony of The Honorable Travis Kavulla

The EPA's Clean Power Plan represents a truly significant realignment, for better or worse, in the paradigm of how and by whom utilities should be regulated.

In creating a regulation that essentially requires States to build new power plants in a gambit to mitigate the emissions of existing ones, the EPA has created a regulation that can be seen as a *de facto* fuel-type or renewable-energy standard.

The EPA's regulation creates a carbon planning function vested in the EPA together with the State environmental regulators and governors. This supplants the traditional oversight of utility resource planning by State utility commissions. This step change in the regulation of utilities will have many consequences, some of which are readily apparent and some of which are as yet unforeseen.

Additionally, the design of the Clean Power Plan may promote uneconomic pathways to complying with the regulation, both in States that traditionally engage in the central regulation of utilities by State commissions, and in markets where competitive forces are today relied upon for the procurement and dispatch of those resources.

Good morning Chairman Whitfield, Ranking Member Rush, and Members of the House Committee on Energy and Commerce, Subcommittee on Energy and Power. My name is Travis Kavulla and I have the honor of serving as the President of the National Association of Regulatory Utility Commissioners (NARUC). It is always a privilege to testify before this committee.

NARUC is a quasi-governmental, non-profit organization founded in 1889. Our membership includes the public utility commissions serving all States and territories. NARUC's mission is to serve the public interest by improving the quality and effectiveness of public utility regulation. Our members regulate the retail rates and services of electric, gas, water, and telephone utilities. We are obligated under the laws of our respective States to assure the establishment and maintenance of such utility services as may be required by the public convenience and necessity and to assure that such services are provided under rates and subject to terms and conditions of service that are just, reasonable, and non-discriminatory.

On October 23, 2015, the Environmental Protection Agency published in the Federal Register the most far-reaching regulation of the electric power sector in the agency's history: the Clean Power Plan.¹ The plan targets sharp reductions in carbon-dioxide emissions from existing plants.

NARUC's members are divided on what should be done to address carbon-dioxide and other greenhouse gas emissions. The association's limited official statements on the plan reflect that division. However, NARUC has advocated unambiguously that States' traditional regulatory oversight over utility resource planning not be eroded and that low-carbon-emitting resources receive credit in the Clean Power Plan. The EPA's regulation falls short of both of those, especially

¹ 40 CFR Part 60, *Carbon Pollution Emission Guidelines for Existing Stationary Sources: Electric Utility Generating Units: Final Rule*, 80 Federal Register 64661 (October 23, 2015).

the first. I elaborate on these arguments in my written statement, occasionally making arguments that represent my views, and not necessarily those of my association as a whole. However, whatever else one believes the Clean Power Plan will do, it represents a marked change in how and by whom utility regulation in the United States is conducted.

The Clean Power Plan Overtakes State Commissions' Role in Utility Regulation

Until the Clean Power Plan, environmental regulations issued under the Clean Air Act have been straightforward, if sometimes controversial. They identify the pollutant that should be abated. They specify the technology which either maximally controls or is most cost-effective in controlling the emission of that pollutant. Then they require the installation of that technology onto a particular power plant or the shut-down of a plant as non-compliant. They also can provide the option to sell or transfer emission allowances to those that have over-complied with the standard. Those plants can transfer their un-used “compliance” or allowances to plants that cannot comply directly with the emission limits imposed.

In short, traditional environmental regulation revolves around installing specific pollution control technologies at the facility that produces the emissions. Certainly, in all previous rules issued under Clean Air Action (CAA) §111(d), which has as its premise the identification of a “best *system* of emissions reduction,” a facility-specific technology has been at the core of the regulation’s emission standard. This has ranged from the “spray cross-flow packed scrubbers” identified for phosphate fertilizer plants to the dry or wet scrubbers to remove fluoride at aluminum plants.²

² In total, there have been only five valid regulations issued under this section of the CAA since the 1970s, and they have been limited to more narrow industries than the entirety of the electric power sector; specifically, they address phosphate fertilizer and aluminum plants mentioned above, as well as kraft pulp mills, sulfuric acid production units, and municipal solid waste landfills. Brief for *Amici Curiae* Former State Public Utility Commissioners, *State of West Virginia, et. al. v. EPA*, Case No. 15-1363, (Feb. 23, 2016), p. 4.

The Clean Power Plan is a departure from this traditional analysis. Instead of focusing on the emitting facility, the EPA instead focuses on “the complex machine” that is “the North American power system.”³

The EPA then set about creating state requirements that were not limited to reducing emissions from coal-fired generators based on facility upgrades, but on the idea that if only natural gas-fired or renewable generation were more prevalent, coal plants would dispatch less often, reducing their emissions. Together, these so-called “building blocks” of the EPA’s requirement-setting process lead to an enhanced emissions standard for coal plants that is impossible to achieve at the specific plants. For several states, the natural-gas and renewable resources necessary to obtain the reductions required by the Clean Power Plan do not even exist.⁴ In short, to regulate existing power plants, the EPA is effectively requiring the construction of *entirely new* generating resources.

This novel approach means that EPA has interpreted the Clean Air Act to give that agency the power, essentially, to plan the resource mix of the U.S. power sector. Effectively, the EPA has created a *de facto* fuel and renewable energy standard.

While the EPA contends States may meet their carbon-dioxide emissions requirements in ways other than by the assumptions the EPA used to set those targets, there are only a limited number of tools to do so. As such I expect that most States will do more or less what the EPA, in its resource-planning exercise, has spelled out as the regulation’s “best system of emissions reduction.” This is especially the case since the EPA, despite its promise of flexibility, has actually

³ *Id.*, citing 80. Fed. Reg. 64,725-64,726 (Oct. 23, 2015).

⁴ One such example is Alabama, which, even were it to increase to output of its existing gas-fired generators to the dispatch rate assumed in the EPA rule, would nonetheless have to build new renewable generation to displace a sufficient amount of coal-fired production to meet the EPA requirement. *See* William S. Scherman & Jason J. Fleischer, “The Environmental Protection Agency and the Clean Power Plan: A Paradigm Shift in Energy Regulation Away from Energy Regulators,” 36 *Energy Law Journal* 355 (2015), p. 384.

precluded States from obtaining credit for certain carbon-abating activities, as discussed at greater length below.

NARUC called upon the EPA at the outset of this rulemaking to “not intrude on the States’ jurisdiction over decisions regarding integrated resource planning and/or resource adequacy or otherwise mandate specific modifications to the mix of fuels and resources in existing or future State generation portfolios.”⁵ NARUC is a 127-year-old organization, and making determinations as to the economic, environmental, and social efficiency of utilities’ investments to serve retail customers has been, for just as long, the province of State utility commissions.⁶ The importance of this State planning expertise is not merely an opinion. It is the foundation of the long-standing legal framework of our country’s electric power sector, which establishes a bright line between the federal and State jurisdiction over generation of electrical energy.⁷ While my association has periodically disagreed with the Federal Energy Regulatory Commission—our counterpart, on oversight of the power sector—that agency’s actions have usually been undertaken in a spirit of cooperative federalism. The same cannot necessarily be said of the EPA. While the agency deserves credit for its outreach to State utility commissions, it has through the Clean Power Plan largely supplanted them as the institution responsible for determining what resource mix best serves the public interest.

⁵ “Resolution on Increased Flexibility with Regard to the EPA’s Regulation of Greenhouse Gas Emissions from Existing Power Plants,” Adopted by the NARUC Board of Directors (Nov. 19, 2013) and the Committee of the Whole (Nov. 20, 2013). Available online at: <http://pubs.naruc.org/pub/53A0C721-2354-D714-5119-A6E9EFD6F5BE> (all hyperlinks last accessed July 1, 2016).

⁶ The only exception to this rule is where a state has chosen consciously to “restructure” their utility industry, in order to remove the cost-recovery of generation from the state-regulatory process and have it be competitively procured in the open market. (Even in this situation, states retain responsibility for the siting of those power plants.) The EPA regulation poses perhaps an equal number of problems with respect to that approach, which are touched upon later.

⁷ Federal jurisdiction was asserted only after utilities got their start, and states began to regulate them as monopolies. When federal legislation occurred, the adoption of the Federal Power Act specifically excluded the federal regulator the jurisdiction “over facilities used for the generation of electric energy.” 16 U.S.C. § 824(b).

The EPA's reach into State resource planning ignores much of what States have done over the years to address the very problem EPA seeks to redress. Three decades ago, States began to adopt more specific statutes which, rather than simply directing State utility commissions to engage in after-the-fact review of utility generation investments, called on regulated utilities to file Integrated Resource Plans (IRPs) subject to review by State utility commissions. These were intended to be processes that took a more perspicacious view of customers' needs, incorporating better demand forecasting, a wider consideration of available resources including energy efficiency, and, indeed, environmental externalities. States of all political stripes adopted such programs, either through legislation or regulation.⁸ Generation-owning utilities, pursuant to these State requirements, typically file every other or every third year a plan to satisfy those multiple requirements, using resource-acquisition and production-cost models to determine an optimal portfolio to supply their customers. The State utility commission then becomes a one-stop shop for consumers and other stakeholders to participate in the vetting of this plan, which informs utilities' actions into the future. In my experience, State utility commissions possess and deploy substantial technical resources in analyzing these plans. They take seriously their mandate to analyze these monopoly plans to serve customers who do not have another choice in provider.

Were the environmental obligation in question here—the reduction of carbon-dioxide emissions—to be expressed as a facility-specific technology or even simply as an explicit carbon price, then those inputs could be modeled transparently within the IRP process that is used to

⁸ For example, in my home state, in 1993, the legislature adopted the *Montana Integrated Least-Cost Resource Planning and Acquisition Act* (1993), codified at Mont. Code Ann. Title 69, Ch. 3, Part 12. It calls for “efficient utility operations, efficient use of utility services, and efficient rates” as well as the “acqui[sition of] resources in a manner that will help ensure a clean, healthful, safe and economically productive environment.” MCA §69-3-1202(1).

identify the least-cost portfolio within the bounds of other restrictions, such as reliability or environmental impact.

This would still leave the State to determine whether the additional capital expense of a pollution control technology, or the operating expense of a carbon price, would be worth the continued benefit of its production, when compared to other generation alternatives. Yet when the EPA adopted a “system” that encompassed the entirety of the State’s electric power production, what it really did was usurp the IRP function of a utility commission and replace it with a carbon-resource planning process undertaken by the State environmental regulator and governor’s office under the Clean Air Act’s §111(d).⁹

The Erosion of State Commissions’ Role has Negative Consequences

It may seem innocuous to hand over functions of the State utility commission to the State environmental regulator—but the functional transfer of authority is highly consequential for several reasons:

- It gives a less experienced regulator control over a resource planning process;
- It makes the resulting plan enforceable as a matter of federal environmental law, sapping the ability of the industry and the regulator to respond nimbly to changing market conditions;
- The scope of the plan, rather than just for a single utility, now becomes the entire State’s electric resource mix, with the likelihood that certain parties are favored over others; and
- It introduces a new level of potentially self-seeking politics into the planning process.

⁹ All states empower their state equivalent of the EPA, and not a utility commission, to create state plans under the Clean Air Act, and it is the legal responsibility, in the end, of a governor to submit a state plan under CAA §111(d). 40 CFR part 51 App. V.2.1.(a) 80 Federal Register at 64856 (October 23, 2015).

State environmental regulators are gifted at what they do, and as a utility commissioner, I would have to look to them, for instance, on an explanation of how dry sorbent injection works to remove harmful metals from the industrial processes of a power plant. Yet those regulators, like the EPA, do not have a wide knowledge of how the electric system as a whole is planned for, operated, and paid for. I have personally talked to a number of State environmental regulators who have expressed confusion as to how utility planning is conducted, and apprehension about being in the driver's seat conducting it. One of them told me, "It was simple when we were just being asked to identify an emissions rate for a power plant and make them responsible for meeting that rate." Now, that regulator will be asked, if the State agency follows EPA's identified "best system of emissions reduction," to engage in a central planning exercise that ordains the amount of renewables, natural gas, coal, and other resources to be part of his or her State's energy mix.

Moreover, the stakes are much higher. A poor job on a utility's IRP might result in a financial disallowance and more prescriptive instructions on what to do in the wake of unsatisfactory utility decision-making. A State §111(d) plan, once approved by the EPA, is legally enforceable as a matter of federal law.¹⁰ This designation affords significantly less room for the errors that inevitably occur in something as complex as electric resource planning.

These plans, indeed, are much more complex because rather than being about the compact between one monopoly utility and its customers, they will be about the entire State's carbon emissions profile. Two years ago, I testified before this subcommittee that the EPA appears to assume that simply because two power plants were in the same State, their operation must be

¹⁰ Under Section 113, EPA may initiate an enforcement action against "any person" (including a State) that has violated a specific requirement or prohibition of a State plan or permit. 42 U.S.C. § 7413(a)(1),(b). This provision makes a requirement or prohibition in a State plan or permit "federally enforceable."

seamlessly interrelated.¹¹ Such misunderstandings remain in the final regulation, and will no doubt be replicated in many State plans. The result? Smaller utilities and their customers may be overlooked and subject to unintended consequences amidst the overarching State §111(d) plan, because of an inevitable regulatory focus on larger players.

Finally, there are the politics endemic in this gambit. State commissions are not above the fray. But they are also not primarily responsible, as governors are for instance, for promoting the creation of jobs and economic development in their State. Instead, my job—as an economic regulator—is to simulate the outcome of what a competitive market might create for the power sector in light of the nature of Montana’s electric sector as primarily a retail monopoly. That means, while I care about jobs, the primary focus is just and reasonable rates which are the product of least-cost decision-making once consideration is given (and additional costs are incurred) for legally required expenditures on environmental and reliability considerations. Every governor, in my experience, has some kind of “energy jobs plan.” It will be a temptation to take such a plan off the shelf—even if it has been rejected by the State’s legislature or utility commission—and make certain modifications necessary to truss it up as a State plan acceptable under the federal Clean Power Plan, and then submit it to the EPA.¹² Once approved, it will—again—be enforceable as a matter of federal law, having offered one part of a State’s political establishment an opportunity for an end-run around the whole.

¹¹ Written Testimony of Commissioner Travis Kavulla, Before the Committee on Energy and Commerce’s Subcommittee on Energy and Power, “State Perspectives: Questions Concerning EPA’s Proposed Clean Power Plan,” (Sept. 9, 2014), pp. 8-10. Available online at: <http://psc.mt.gov/commissioners/District1/pdf/Testimony%20before%20House%20Power%20and%20Energy%20Subcommittee%20on%20EPA%20Carbon%20Rules.pdf>

¹² EPA, meanwhile, has no meaningful obligation—as would be a state utility commission—to review these plans for their economic efficiency. It cares only about compliance with the emissions standard. Moreover, the EPA has even seemingly identified that their regulation is more appetizing when cloaked in rhetoric about “jobs” and “investment,” which fact sheets from the agency regularly extol. *See, e.g.*, <https://www.epa.gov/cleanpowerplan/fact-sheet-clean-power-plan-clean-energy-now-and-future>

Meanwhile, regulated utilities may even cheer an economically inefficient plan, because it gives them the opportunity to grow their “rate base.”¹³ Such utilities will present those costs not as the product of an IRP’s least-cost evaluation, but as the fixtures of a legally binding carbon §111(d) plan. This puts State commissions in the impossible position of not being able to deny recovery of those costs—even if they do not appear to have been the most efficient path to complying with the environmental regulation—because those investments were nonetheless the requirement of a federally approved, State carbon resource plan.

As a number of former utility commissioners have observed, “PUCs do retain a sole, ministerial function: These regulators get to present the bill to ratepayers for costs incurred to satisfy EPA’s Power Plan.”¹⁴

My concern with this framework is that it erodes the independence and data-driven nature of decision-making which is the aspiration and hopefully the practice of State commissions. In Montana, as in several other States, public service Commissioners, like Congressional representatives, are elected. Presumably, Montana and those other States decided to elect their utility regulators to further insulate the State commission from political influence by the governor or individual legislators on matters of utility regulation. The Clean Power plan up-ends that framework.

The Clean Power Plan Complicates Efforts to Introduce Competition into Electric Markets

Starting in the late 1990s, other States, particularly in the Eastern United States, made the choice to open retail electric markets to competition. This usually involved requiring regulated utilities to divest their generation assets to unregulated affiliates or other firms, allowing customers

¹³ “Rate Base” is the total amount of invested capital upon which a regulated firm is allowed to make a return through the rates approved by a utility commission.

¹⁴ *Amici*, p. 28.

to choose a retail supply provider, and establishing, under FERC's supervision, a wholesale market where through a security constrained economic bidding process the newly competitive generators earn market-based revenues (in addition to whatever other deals they may obtain from the downstream competitive providers).

Those States have largely written their IRP function out of existence, because regulated utilities no longer have monopolies over customers, and no longer own generation which is paid by those captive sets of customers.

Ironically, the Clean Power Plan may re-introduce a central planning function to some of these States. There is very little in the EPA regulation limiting how highly prescriptive a §111(d) plan could be in terms of ordaining the construction of this or that resource. Picking winners and losers is something that sound, technologically neutral public policy eschews. Yet it is not forbidden by the Clean Power Plan, which does not require technological neutrality in the obtainment of its carbon-reduction goals. Again, it may allow a governor to override through the submission of a §111(d) plan the competitive framework enacted by those States' legislative processes.

This is not an academic issue. A number of States and FERC have been engaged lately in litigation on this matter. The disputes have focused on whether States' attempts to inject new generation into restructured, competitive markets for generation, through State-based planning or the retail ratemaking process, distorts the market and is thus pre-empted by the Federal Power Act's grant of exclusive jurisdiction over the "sale for resale" of electricity to FERC.¹⁵ One recent attempt by the State of Maryland was found unlawful in the U.S. Supreme Court's latest term, in

¹⁵ Under the Federal Power Act, FERC has exclusive authority to regulate "the sale of electric energy at wholesale in interstate commerce." 16 U.S.C. § 824(b)(1). A wholesale sale is defined as a "sale of electric energy to any person for resale." 16 U.S.C. § 824(d).

which the majority noted that a State might “encourag[e] production of new or clean generation through measures ‘untethered to a generator’s wholesale market participation.’”¹⁶ In a re-match where the FPA and FERC are pitted against a State §111(d) plan cloaked in EPA approval, which will win?

Those who have championed competition are worried about the “slippery slope towards unraveling the market design.”¹⁷ The Clean Power Plan threatens competition in electric markets because it is more likely than not that whatever the States do to comply with the regulation, it will not be solely an explicit price on carbon or cap-and-trade regime that could be reconciled to these markets.

Even the EPA has accorded certain carbon-abating resources favorable treatment, while not doing so for others. Nuclear plants whose owners must decide whether to extend their licenses, for instance, would receive no credit under the EPA’s calculations for their continued contributions to carbon-emissions abatement. This has led former Energy Secretary Steven Chu to criticize the Clean Power Plan in the past month, arguing, “We should make a Clean Power Plan that’s based on clean energy, not renewable energy.”¹⁸ The regulation falls short of what NARUC asked of the agency in November 2014, providing credit to States for preserving or extending the life of the nuclear fleet.¹⁹ In other words, even the EPA has not adopted the economically efficient premise that carbon-abating resources should be treated in a technologically neutral manner. States will

¹⁶ *Hughes v. Talen Energy Mktg., LLC*, 136 S. Ct. 1288, 1299 (2016).

¹⁷ William W. Hogan, “Electricity Markets and the Clean Power Plan,” *Electricity Journal* (Nov. 2015), p. 23.

¹⁸ Jeff McMahon, “Steven Chu Criticizes Clean Power Plan for Neglecting Nuclear,” *Forbes* (June 5, 2016), <http://www.forbes.com/sites/jeffmcmahon/2016/06/05/steven-chu-criticizes-clean-power-plan-for-neglecting-nuclear/#43cb0f1b7f35>

¹⁹ *Resolution Recognizing the Importance of Nuclear Power in Meeting Greenhouse Gas Goals*, Adopted by the NARUC Board of Directors (Nov. 18, 2014) and the Committee of the Whole (Nov. 19, 2014), available at: <http://pubs.naruc.org/pub/53A0D13B-2354-D714-51BF-BC0BB4BE2E06>

necessarily reflect the EPA's distortion in their plans. Moreover, it is likely State §111(d) plans will add similar distortions. The implementation of the Clean Power Plan probably will have the semblance of a political compromise that involves creating a carbon resource plan where politically favored power plants are brought online either through a direct mandate of a State plan, or in exchange for Emissions Reductions Credits or similar instruments created by regulatory fiat and which other generators are required to obtain. The production of those new power plants then will increase supply in the competitive markets, suppressing the market clearing prices that all resources rely upon for their continuing operations, including other clean energy resources that were previously constructed but which do not obtain credit from the EPA for Clean Power Plan compliance.

If this *sounds* complicated, let me assure the subcommittee: *It is*.

It is so complicated that the EPA appears merely to hope that it will not be a grave problem; the agency has offered little in the way of meaningful guidance of how this environmental regulation, which has a central planning notion at its fundament, can be reconciled to the restructured markets for electricity. Indeed, of nine possible ways to incorporate the Clean Power Plan into the competitive wholesale markets, seven of them are faulted by Prof. William Hogan, an expert on market design, for having a variety of ill effects from reducing the efficiency of dispatch to threatening reliability to undoing the competitive project altogether.²⁰

Conclusion

The point I would like to leave the subcommittee with is this: There have been ups and downs to the role and responsibilities of State utility commissions over the past century. But the

²⁰ The two workable options that Prof. Hogan identifies are a carbon tax or a cap-and-trade program. *Hogan*, pp. 23-29.

Clean Power Plan represents a truly significant realignment, for better or worse, in the paradigm of how and by whom utilities should be regulated.

The design of the Clean Power Plan may promote uneconomic pathways to complying with the regulation, both in States that traditionally engage in the central regulation of utilities by State commissions, and in markets where competitive forces are relied upon for the procurement and dispatch of those resources.

Thank you again for the subcommittee's invitation to be here today.