

**UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION**

Carbon Pricing in Organized Wholesale)
Electricity Markets)
)

Docket No. AD20-14-000

**TECHNICAL CONFERENCE COMMENTS
OF MATTHEW E. PRICE**

I. SUMMARY

I appreciate the opportunity to serve as a panelist for this Technical Conference concerning Legal Considerations for State-Adopted Carbon Pricing and RTO/ISO Markets. In announcing the conference, the Commission has asked whether it could approve a Section 205 filing by an RTO¹ that incorporates a state-determined carbon price into the RTO’s market design.² The Commission can do so.

Under Section 205, the Commission must approve a tariff filing if the proposed tariff is just, reasonable, and not unduly discriminatory—even if there might also be other reasonable approaches. For a number of reasons, it is reasonable for an RTO to decide, after following its own internal governance procedures, that its market design should incorporate a state-determined carbon price. For one thing, carbon emissions are, from an economic standpoint, a well-accepted externality—that is, a marginal cost of production that is not currently reflected in price signals. As with other costs, it is reasonable to account for those costs in dispatching resources. For another, states have adopted a wide range of policies governing the power sector in an attempt to reduce carbon emissions, but there is broad agreement that a carbon price would be the most

¹ I use the term RTO to refer interchangeably to RTOs and ISOs.
² Supplemental Notice of Technical Conference (Aug. 5, 2020) at 1.

efficient policy. However, because states lack jurisdiction to regulate power production in other states, they are hampered in their ability to enact a successful carbon price due to leakage.

Incorporating a state's carbon price into an RTO dispatch mechanism ensures that states can achieve their policy goals while also promoting the efficiency of wholesale market outcomes.

To reject such a Section 205 filing, the Commission would need to conclude that it is unreasonable for a private party—the RTO, after all, is not a public regulator—to make these choices. The notion that the Commission itself improperly becomes an environmental regulator by accepting a Section 205 filing of this kind misconceives the reactive nature of review under Section 205. By accepting such a filing, the Commission does not impose any federal policy onto unwilling states or on an unwilling utility. States have allowed their load-serving entities to join an RTO, with the understanding that the RTO, through its internal governance processes, will make market design decisions governing the RTO's footprint. In a multi-state RTO, some states may support a given decision, while other states may object. But so long as the ultimate decision is reached in accordance with the RTO's internal governance requirements, the Commission's task is simply to review the outcome of that internal process—the proposed tariff—and decide whether it is reasonable. Nor does accepting such a Section 205 filing intrude on state jurisdiction under the Federal Power Act. Just as the Commission can accept filings creating a wholesale demand response product, or allowing storage to participate in wholesale energy markets, the Commission can accept a filing incorporating a state-determined carbon price into an RTO dispatch mechanism, because it is a wholesale market rule aimed at promoting wholesale market efficiency.

II. DISCUSSION

A. Under Section 205, the Commission Asks Only Whether a Public Utility's Choice Is Reasonable.

The premise of the legal discussion in this Technical Conference is that “the Commission is presented with a proposal to integrate a carbon price set by a state into an RTO/ISO market design.”³ Whether that proposal originates with the RTO under Section 205, or instead with a market participant under Section 206, has a significant bearing on the legal analysis. The remainder of these comments assume that the RTO has made the tariff filing under Section 205.

A public utility's burden under Section 205 is only to show that its proposed rate is just and reasonable.⁴ There is not only one just and reasonable rate. Accordingly, the question is not whether the Commission should *mandate* a carbon price. Rather, the question is whether a public utility's decision to integrate a state-determined carbon price is a permissible one—one that falls within the range of reasonableness. In answering that question, the Commission need not adopt any policy at all regarding the best approach.

B. An RTO Decision to Integrate a State-Determined Carbon Price Into Its Market Design Is Reasonable.

For a number of reasons, an RTO can reasonably decide to incorporate a state-determined carbon price into its market design.

First, as an initial matter, an RTO is an unusual public utility. The statute directing the Commission to “promote and encourage regional districts for the voluntary interconnection and coordination of facilities for the generation, transmission, and sale of electric energy,”⁵ on which

³ Supplemental Notice of Technical Conference (Aug. 5, 2020) at 1.

⁴ *City of Winnfield v. FERC*, 744 F.2d 871, 874-75 (D.C. Cir. 1984).

⁵ 16 U.S.C. § 824a(a).

the Commission relied when establishing RTOs in Order No. 2000,⁶ specifically identifies environmental considerations as relevant to the RTO’s mission. Section 202(a) of the Federal Power Act directs the Commission to promote and encourage regional coordinating entities like RTOs “[f]or the purpose of assuring an abundant supply of electric energy throughout the United States with the greatest possible economy *and with regard to the proper utilization and conservation of natural resources.*”⁷ This statutory language strongly suggests that it is appropriate for an RTO to account for state environmental policies in its market design. Indeed, Section 202(a) suggests Congress’s view that the fundamental economic purpose of an entity like an RTO—which is to “assur[e] an abundant supply of electric energy ... with the greatest possible economy”⁸—is necessarily intertwined with environmental considerations (to which “regard” must be given), so that if an RTO were to pursue its economic purpose *without* regard for the environmental consequences, that would violate Congress’s directive. Accordingly, it is difficult to see why an RTO would be *prohibited* from choosing to give “regard to the proper utilization ... of natural resources,”⁹ including by discouraging the over-utilization of polluting resources through the incorporation of a carbon price in its market design.

Second, the RTO’s function to assure “abundant supply of electric energy ... with the greatest possible economy”¹⁰ by itself makes it reasonable for an RTO to integrate a state-determined carbon price in its market design. The term “economy” is not a defined term, but the

⁶ *Reg'l Transmission Organizations*, 89 FERC ¶ 61,285, at P 61 (1999) (stating that, under FPA Section 202(a), the Commission “clearly has the authority to direct public utilities as well as non-public utilities to consider the regional coordination that would result from joining an RTO”).

⁷ 16 U.S.C. 824a(a) (emphasis added).

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.*

ordinary meaning in this context is the “thrifty and efficient use of material resources.”¹¹ Basic economic principles teach that, in order for society’s material resources to be allocated in a socially efficient manner, the private marginal cost of using those resources (that is, the marginal cost faced by the producer that is using them) must equal the social marginal cost of using those resources (that is, the marginal cost of their use faced by society as a whole). If by using certain resources (say, coal), a producer imposes greater costs on society (for example, through pollution) than the producer itself pays, society’s material resources will not be used in an efficient manner. In this example, the producer will burn more coal than is efficient. A carbon price addresses this inefficiency by forcing the producer to internalize the full marginal cost of its use of a polluting resource. The resulting market outcomes (which, in this example, may reflect a reduction in coal use in favor of other, non-emitting fuel) reflect a more “thrifty and efficient use of material resources.”¹² Accordingly, purely from the standpoint of economic efficiency, it is reasonable for an RTO to incorporate a carbon price in its market design.

Third, integrating a state-determined carbon price into the RTO market design can lead to more efficient market outcomes by harmonizing state policies that are all aimed at carbon emissions reduction, but that approach the problem in a fragmented manner. As the Commission is aware, states have pursued carbon reduction goals through a variety of different mechanisms that impact wholesale electricity prices, including cap-and-trade programs like RGGI, and RECs and ZECs. From the standpoint of state policymakers, the interconnected, interstate aspect of the grid makes it challenging for states to achieve their carbon-reduction goals through a carbon

¹¹ See Merriam-Webster online dictionary, <https://www.merriam-webster.com/dictionary/economy>; *Yates v. United States*, 574 U.S. 528, 537 (2015) (looking to dictionary for definition of statutory term’s ordinary meaning).

¹² 16 U.S.C. 824a(a).

price—even in a single-state RTO, but especially in a multi-state RTO. States have the power to impose a carbon price on generators within their boundaries, and can also impose a carbon price on electricity consumed in the State. But if energy flows are not tagged, it is impossible to know whether a particular quantity of energy that flows into a state is destined for consumption there, or is simply being transmitted through the state on the interstate grid (and thus cannot be regulated by the state);¹³ and, moreover, that flow may not be traceable back to a source with a known carbon intensity. The consequence of a state’s practical inability to effectively regulate the carbon emissions of electricity *consumed* in the state (rather than produced there) is leakage: if a state imposes a carbon price on generators located in the state, the market will respond by shifting production to more costly generators in other states, without regard to their carbon emissions. Leakage significantly undercuts the effectiveness of a single-state carbon price.

From the standpoint of a state that wishes to promote clean generation, subsidizing zero-emissions generators is a more sensible strategy, because it avoids leakage. The state knows that the generators chosen for the subsidy will receive it. While the state undoubtedly has the authority to enact such programs,¹⁴ the Commission has found that such programs have adverse impacts on price formation in the wholesale capacity market.¹⁵

By incorporating a state-determined carbon price into its market design, an RTO can help to harmonize state and federal policy goals. Only an RTO-wide carbon price would entirely solve leakage within the RTO. Border adjustments solve the leakage problem for states that are

¹³ See, e.g., *North Dakota v. Heydinger*, 825 F.3d 912, 921 (8th Cir. 2016).

¹⁴ *Coal. for Competitive Elec. v. Zibelman*, 906 F.3d 41, 55 (2d Cir. 2018), *cert. denied sub nom. Elec. Power Supply Ass'n v. Rhodes*, 139 S. Ct. 1547 (2019); *Elec. Power Supply Ass'n v. Star*, 904 F.3d 518, 524 (7th Cir. 2018), *reh'g denied* (Oct. 9, 2018), *cert. denied*, 139 S. Ct. 1547 (2019).

¹⁵ See *Calpine Corp. v. PJM Interconnection, L.L.C.*, 169 FERC ¶ 61,329 (2019), *on reh'g*, 171 FERC ¶ 61,035 (2020).

net importers of electricity—they prevent out-of-state generators from underbidding in-state generators that face a carbon price. But border adjustments do not solve the leakage problem for states that predominantly export electricity for consumption elsewhere. The exporting state’s emitting plants will face a carbon price, while emitting plants in other states will not, and thus the effect of a carbon price on the net exporting state will be to shift production to states without a carbon price. Nevertheless, at least for net importing states, the RTO, by incorporating border adjustments into its market design, can help the state more effectively regulate the carbon intensity of energy consumed within its borders, reducing leakage. As a private actor subject to federal regulation, an RTO can take action affecting its members that states, exercising their regulatory power under the dormant Commerce Clause, cannot. Moreover, the state and market participants are able to leverage the RTO’s existing settlement processes, which reduces administrative costs.

A carbon price is also the most efficient way to promote carbon reduction goals, since it treats all zero-emitting plants the same (in contrast to REC programs, for example, which often provide much greater support to solar facilities than to wind), and recognizes the carbon-reduction benefits of low-emitting natural gas plants relative to other more carbon-intensive fossil fuel plants. Moreover, incorporating a state-determined carbon price into the RTO’s market design may lead states to eliminate their subsidy programs as unnecessary. Indeed, many subsidy programs—including ZECs, for which the price reflects energy market forecasts,¹⁶ and RECs, for which the price is responsive to energy market conditions—are designed to be displaced by a carbon price. Thus, an RTO’s incorporation of a state-determined carbon price into the RTO’s market design helps states better achieve their environmental objectives, while at

¹⁶ *E.g.*, 20 ILCS 3855/1-75(d-5)(1)(B)(iii)(aa).

the same time improving the efficiency of wholesale market outcomes relative to the status quo. It is certainly reasonable for an RTO to choose that path.

C. Approving an RTO Tariff Incorporating a State-Determined Carbon Price Does Not Transgress Limits on the Commission’s Authority.

There is no jurisdictional barrier to the Commission’s ability to review a Section 205 filing by an RTO seeking to incorporate a state-determined carbon price into its market design.

Approving such a Section 205 filing does not make the Commission into an environmental regulator. In approving a Section 205 filing, the Commission simply recognizes a public utility’s proposed rate as reasonable; the Commission does not itself impose that rate on the public utility. The Commission’s role in a Section 205 proceeding is “essentially passive and reactive.”¹⁷ Even if the Commission lacked the power to *obligate* RTOs to incorporate a carbon price, it could still determine that it is reasonable for the RTO, a private party, to make such a choice itself through its governance processes.

Approving such a filing also does not intrude on a state’s jurisdiction to regulate generation facilities.¹⁸ The RTO here has, by hypothesis, proposed incorporating the state-determined carbon price because doing so will improve the efficiency of wholesale market outcomes. Just as the Commission is empowered to adopt rules creating a wholesale demand response product, even though it lacks the authority to directly regulate the consumption of energy at retail, so too the Commission can approve a Section 205 filing integrating a carbon price into the wholesale market design. “When FERC regulates what takes place on the

¹⁷ *City of Winnfield*, 744 F.2d at 876.

¹⁸ *See* 16 U.S.C. 824(b).

wholesale market, as part of carrying out its charge to improve how that market runs, then no matter the effect on [the areas reserved to the states], § 824(b) imposes no bar.”¹⁹

Nor does such an approval improperly impose one state’s policy preferences on other states that may have different policy preferences. As an initial matter, when a state chooses for its utilities to participate in a multi-state RTO, the state necessarily exposes its utilities and its citizens to the effects of other states’ policies. A cap-and-trade program like RGGI, for example, raises energy prices even in PJM states, like Pennsylvania, that are not members. A state cannot expect to participate in an interstate market while at the same time hermetically sealing itself against the effects of other states’ policies. An RTO deals with this problem by including states among its stakeholders. At the end of the day, however, the RTO will select a market design through its established governance process. Some states may support the market design, and others may dislike it.

Under the status quo, for example, RTOs have made the decision to select market designs that are agnostic as to carbon emissions. This disadvantages states that wish to discourage carbon emissions, but have no effective means in an interstate market to prevent leakage. One could say that the status quo improperly imposes the preferences of non-carbon-regulating states—which will happily have their own power plants increase production—on the preferences of states that wish to regulate carbon. The reality, however, is that every market design choice favors some interests and disfavors others, and by permitting their load-serving entities to participate in an RTO, states have agreed to have those tradeoffs resolved by the RTO’s governance structure.

¹⁹ *FERC v. Elec. Power Supply Ass’n*, 136 S. Ct. 760, 776 (2016); see also *id.* (“[W]hatever the effects at the retail level, every aspect of the regulatory plan happens exclusively on the wholesale market and governs exclusively that market’s rules.”).

When the Commission is asked to approve the results of that process as reasonable, it does not necessarily take sides in the RTO's internal debate; after all, multiple approaches, each of which will impact different states in a different manner, may be reasonable. The Commission's role, in reviewing a Section 205 filing, is to accept a public utility's proposed rate, so long as it is reasonable. And for all the reasons already discussed above, an RTO's decision to incorporate a state-determined carbon price into its market design is a reasonable choice to make—even if other choices might also be reasonable.

Finally, approving a Section 205 filing including a carbon price is not unduly discriminatory. The prohibition on undue discrimination simply requires that differential treatment be justified—and, as discussed above, there are sound policy reasons for an RTO to propose such a market design.²⁰ Tariff revisions intended to enhance the efficiency of market outcomes frequently will tend to favor certain generation technologies over others. For example, fast-start pricing advantages combustion turbines over non-dispatchable resources. But such a provision is not unduly discriminatory, despite the differential impact, to the extent it reflects genuine differences, and recognizing those differences contributes to more efficient market outcomes.

²⁰ See, e.g., *Advanced Energy Mgmt. All. v. FERC*, 860 F.3d 656, 670 (D.C. Cir. 2017) (“The court will not find a Commission determination to be unduly discriminatory if the entity claiming discrimination is not similarly situated to others.”) (quoting *Transmission Agency of N. Cal. v. FERC*, 628 F.3d 538, 549 (D.C. Cir. 2010)).

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Respectfully submitted,

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