

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

*Carbon Pricing in Organized
Wholesale Electricity Markets*

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) Docket No. AD20-14
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Opening Statement of Ari Peskoe

Whether a state imposes a carbon price on generation facilities or load-serving entities, pricing emissions is a permissible state action under the Federal Power Act. Like many regulations, a state-set carbon price may raise sellers' production costs. The Commission allows sellers to recover in wholesale rates compliance costs associated with emissions regulations, and the Commission would have no basis to prevent regulated entities from passing through costs of a state-set carbon price.

Notices in this docket focus this panel on legal issues with a proposal to "integrate" a state-set carbon price into an RTO/ISO market. As I understand that charge, the Commission is interested in whether there are legal barriers that would prevent it from approving a tariff that adjusts price formation or dispatch processes to reflect buyers' preferences for energy from low-emission facilities or to account for cross-border effects of sellers including compliance costs in their offers.

As I provide in my filing in this docket, the Commission has already found RTO/ISO tariffs that integrate emissions compliance costs are just and reasonable.

I also understand that the Commission may be interested in its authority to approve a state-set carbon price filed by an RTO/ISO.

Over the past two decades, the Commission has attempted to continuously improve RTO/ISO markets, including by adapting them to industry changes. The Commission has justified its findings that proposed changes to these markets are just and reasonable on numerous grounds, including that changes enhance competition, guide resource entry and exit, compensate resources at prices that reflect the value of their services, improve dispatch, and ensure prices allow sellers to recover their costs. This non-exhaustive list illustrates that in reviewing proposed tariff filings the Commission is not constrained by any particular definition of just and reasonable. The Federal Power Act's capacious ratemaking standards provide the Commission

with flexibility to improve the operation of RTO/ISO markets, including by approving an RTO carbon price and rules that integrate that price into the market design.

Approving a tariff that sets and integrates a carbon price would not transform the Commission into an environmental regulator.

The Supreme Court's most recent decision about the scope of the Commission's authority teaches that when the Commission does "no more than follow the dictates of its regulatory mission to improve the competitiveness, efficiency, and reliability of the wholesale market," courts will be reluctant to cut off the Commission's jurisdiction in the absence of a clear statutory bar.

Integrating a carbon price can fit well within the Commission's mandate as a market regulator.

Finally, facilitating carbon emissions reductions is not strictly an environmental goal. Market participants, including the largest utilities, have made emissions commitments. Investors are demanding emissions disclosures. High-emitting plants are retiring. Interconnection queues are dominated by non-emitting resources. Policymakers are requiring reductions. Financial regulators are warning about costs of inaction, including not pricing emissions. No serious conversation about the future direction of the power industry ignores carbon emissions. The Commission has a duty to encourage the industry's orderly development. It should not dismiss carbon pricing as someone else's job.

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Pre-Technical Conference Filing of Ari Peskoe

The Second Supplementary Notice in this docket announced that the panel on legal considerations “will explore general legal issues that may arise under the Federal Power Act when the Commission is presented with a proposal to integrate a carbon price set by a state (or group of states) into an RTO/ISO market design.” I understand the term “integrate” to mean that the RTO/ISO would change its existing price formation or dispatch rules to account for the state-set carbon price. For example, “integration” could include adjustments aimed at neutralizing advantages of generators not subject to the state-set carbon price.

With that understanding, in this filing I briefly address the five topics listed in the Notice’s description of the legal panel. I find that the Commission may find that an RTO tariff integrating a state-set carbon price is just and reasonable and not unduly discriminatory. Doing so would be consistent with Commission precedent and well within the Federal Power Act’s jurisdictional confines. I also conclude that there is no basis for the Commission to approve a tariff that would exclude carbon price compliance costs from rates.

1. Threshold questions concerning the Commission’s statutory authority and other jurisdictional considerations under the Federal Power Act (FPA) associated with implementation of carbon pricing in the RTO/ISO markets.

Response: Energy prices in RTO/ISO markets compensate resources for their production costs, which include costs of complying with environmental regulations. The Commission has recognized that environmental compliance costs are appropriately included in wholesale rates, and there is no basis for the Commission to treat carbon price costs any differently. With regard to the Commission’s authority to integrate a state-set carbon price, the Commission has broad authority to improve wholesale markets. There is no legal limit that would prevent the Commission from approving a tariff that improves the wholesale market by addressing a state-set carbon price.

- a. Locational Marginal Prices (LMPs) ideally compensate all resources for the variable cost of providing service. *See* Notice, Docket No. AD14-14, Price Formation in Energy and Ancillary Services Markets Operated by RTO/ISOs, Jun. 14, 2014; *New York Independent System Operator*, 167 FERC ¶ 61,057 at P 11 (2019) (finding NYISO’s rules unjust and unreasonable because they “do not allow prices to reflect the marginal cost of serving load”); *PJM Interconnection*, 171 FERC ¶ 61,153 at PP 81–83 (2020) (finding rules unjust and unreasonable because they “fail[] to produce market prices that reflect the marginal cost of providing reliable service”).

- b. The Commission has approved rates that include costs of complying with environmental regulations. See *Policy Statement and Interim Rule Regarding Ratemaking Treatment of the Cost of Emissions Allowances in Coordination Rates*, 59 Fed. Reg. 65,930 (Dec. 22, 1994) (“We will allow the recovery of incremental costs of emission allowances in coordination rates whenever the coordination rate also provides for recovery of other variable costs on an incremental basis.”); *San Diego Gas & Electric v. All Sellers*, 95 FERC ¶ 61,418 (2001) (finding that “mitigation fees associated with NO_x emissions are a legitimate cost of producing energy” and instructing the CAISO to “to submit tariff modifications incorporating an emission allowance administrative charge”); *California Independent System Operator Corp.*, 153 FERC ¶ 61,087 (2015) (approving proposed “greenhouse gas bid adder enhancements” to the Energy Imbalance Market that “allow[] a resource to recover its greenhouse gas compliance costs” imposed by California’s CO₂ cap-and-trade program); *Grand Council of Crees v. FERC*, 198 F.3d 950, 957 (noting that “of course” just and reasonable rates may account for a seller’s “need to meet environmental requirements [that] may affect the firm’s costs”).
- c. The FPA empower the Commission to approve an RTO/ISO tariff that integrates a state-set carbon price. When the Commission does “no more than follow the dictates of its regulatory mission to improve the competitiveness, efficiency, and reliability of the wholesale market,” courts will be reluctant to cut off the Commission’s jurisdiction in the absence of a clear statutory bar. *FERC v. Electric Power Supply Ass’n.*, 136 S.Ct. 760, 779 (2016); *In re Permian Basin Area Rate Cases*, 390 U.S. 747, 780 (1968) (“We are, in the absence of compelling evidence that such was Congress’ intention, unwilling to prohibit administrative action imperative for the achievement of an agency’s ultimate purposes.”).

2. The legal analysis of a filing under the FPA proposing to integrate a state-set carbon price into an RTO/ISO market, including the application of the Commission’s just, reasonable and not unduly discriminatory or preferential standard set forth under FPA sections 205 and 206.

Response: The Commission may find that an RTO/ISO rate design that integrates a state carbon price in a manner that enhances competition, improves price formation, optimizes commitment and dispatch of resources, or achieves a purpose consistent with the Federal Power Act, is just and reasonable. Courts are unlikely to overturn the Commission’s finding.

- a. The Commission [] “undertakes to ensure ‘just and reasonable’ wholesale rates by enhancing competition—attempting. . . ‘to break down regulatory and economic barriers that hinder a free market in wholesale electricity.’” *FERC v. EPSA*, 136 S.Ct. 760, 768 (2016) (quoting *Morgan Stanley Capital Group v. Public Util. Dist. No. 1 of Snohomish Cty.*, 554 U.S. 527, 536 (2008)).
- b. In determining whether a rate is just and reasonable, “the Commission [is] not bound to the use of any single formula or combination of formulae” and may make “pragmatic adjustments” to adapt to particular circumstances. *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944) (quoting *FPC v. Natural Gas Pipeline Co.* 315 U.S. 575, 586 (1942)).

- c. “Markets should be designed so that as much as possible the market results in efficient prices that send appropriate signals for new entry.” *PJM Interconnection*, 110 FERC ¶ 61,053 at P 31 (2004). Energy market prices should send “accurate price signals” that “encourage more efficient supply and demand decisions in both the short and long run.” *New England Power Pool & ISO New England Inc.*, 102 FERC ¶ 61,248 at P 12 (2003).
- d. Courts must “afford great deference to the Commission in its rate decisions.” *Morgan Stanley Capital Group*, 554 U.S. at 532 (2008) (citing *FPC v. Texaco Inc.*, 417 U.S. 380, 389 (1974); *In re Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968)).
- e. The Commission has approved RTO/ISO tariff amendments that aim to facilitate efficient dispatch of resources subject to environmental regulation. *California Independent System Operator*, 163 FERC ¶ 61,211 (2018) (finding CAISO filing that will enable “dispatch [of] use-limited resources when they are most needed” is just and reasonable).

3. Previous Commission precedent regarding tariff revisions proposed by RTOs/ISOs to incorporate costs associated with participation in state or regional cap-and-trade programs, and whether and how such precedents may inform future consideration of proposals to implement carbon pricing in the RTO/ISO markets.

Response: The Commission has found that tariff amendments integrating a state’s cap-and-trade program within a multi-state market are just and reasonable, including amendments that aim to address CO₂ emission leakage concerns. The latter order is particularly noteworthy because the tariff amendment integrated the state’s cap-and-trade program into the market design in order to address an issue that is pertinent only under California law.

- a. *California Independent System Operator*, 153 FERC ¶ 61,087 (2015) (approving refinement to EIM GHG bid adder that permits CAISO to reflect cap-and-trade compliance costs within LMPs for resources serving CAISO demand); *California Independent System Operator*, 165 FERC ¶ 61,050 (2018) (approving EIM tariff amendment that allows to CAISO to “more accurately attribute EIM transfers to the actual generation being incrementally dispatched to serve California load and [] reduce the attribution to CAISO load of EIM resources that would have generated even without CAISO load”).

4. Whether potential rate impacts stemming from the integration of carbon pricing into RTO/ISO markets are just, reasonable, and not unduly discriminatory or preferential.

Response: Potential rate increases are a legitimate issue for the Commission’s consideration in a section 205 proceeding. Even if the Commission finds that rate increases are very likely due to integration of the state-set carbon price, it may still find the RTO/ISO tariff filing just and reasonable.

Market rules and transmission planning and cost allocation decisions affect market participants differently. Spillover effects due to differences in public utilities’ assets, state policies, or other factors are an inevitable consequence of the operation of multi-utility RTO/ISOs. Moreover, state-authorized responses by RTO members to those differences may

affect rates paid by other RTO members unevenly. For example, the Commission has approved the Fixed Resource Requirement (FRR) as an alternative to participation in PJM's capacity auction (RPM). An RTO member's decision of whether to fulfill its capacity obligations through the FRR or RPM may affect capacity rates paid by other RTO members. *See, e.g., Internal Market Monitor Report on ComEd FRR*, Feb. 5, 2020, at 12 (projecting that if ComEd uses the FRR mechanism other RTO members will pay higher rates through the RPM). Those price effects — which may be triggered in part by a state's directive to the RTO member to choose a particular capacity procurement mechanism — do not necessarily render the PJM tariff unjust and unreasonable and unduly discriminatory. Similarly, where an RTO/ISO proposes to integrate a state-set carbon price, potentially leading to higher energy rates in the non-carbon price region, the Commission may find the proposed integration just and reasonable.

Moreover, a rate increase can be just and reasonable if it is warranted. The Commission may find that an RTO/ISO rate design that integrates a state carbon price in a manner that enhances competition, improves price formation, optimizes commitment and dispatch of generating resources, or achieves another purpose consistent with the Federal Power Act, is just and reasonable. For example, the Commission may find that integrating a state-set carbon price facilitates the industry's orderly development. The Commission may also conclude that it is just and reasonable to adapt RTO/ISO markets to industry changes.

Finally, energy market price increases due to integration of a state-set carbon price may be offset by decreases in capacity rates. *PJM Interconnection*, 171 FERC ¶ 61,153 at PP 308–314 (2020). Focusing only on energy rates does not necessarily reflect impacts to consumers.

- a. “Increased costs can be just and reasonable if the costs are warranted.” *Advanced Energy Management Alliance v. FERC*, 860 F.3d 656, 662 (D.C. Cir. 2017).
- b. “A primary purpose of the Federal Power Act . . . ‘was to encourage the orderly development of plentiful supplies of electricity . . . at reasonable prices.’ To carry out this purpose the Commission may consider non-cost factors as well as cost factors in setting rates.” *Public Utilities Com’n of California v. FERC*, 367 F.3d 925, 929 (D.C. Cir. 2004) (quoting *NAACP v. FPC*, 425 U.S. 662, 670 (1976) and citing *Permian Basin Area Rate Cases*, 390 U.S. 747, 791 (1968)); *PJM Interconnection, et al.*, 155 FERC ¶ 61,157 at P 30, n. 39–40 (listing related federal court decisions and Commission orders).
- c. It is “perfectly legitimate for the Commission to base its findings about the benefits of [the proposed tariff amendment] on basic economic theory, given that it explained and applied the relevant economic principles in a reasonable manner.” *Sacramento Mun. Utility District v. FERC*, 616 F.3d 520, 531 (D.C. Cir. 2010); *see also South Carolina Public Service Authority v. FERC*, 762 F.3d 41, 68–71 (D.C. Cir. 2014).
- d. In Order No. 2000, the Commission recognized the “concern of low cost states that RTOs could result in exports of their low cost power to other states” but found it more likely that in the long-term low-cost states would see net benefits from RTO membership. The Commission has also rejected a protest filed by an RTO member against RTO expansion, reiterating its generic conclusion that RTO expansion is just

and reasonable despite its potential to impose costs on certain wholesale or retail customers. See *The New PJM Companies*, 103 FERC ¶ 61,008 at PP 40–41 (2003).

- e. “[A] forecast of the direction in which future public interest lies necessarily involves deductions based on the expert knowledge of the agency.” *FPC v. Transcontinental Pipeline Corp.*, 365 U.S. 1, 29 (1961) (citing *Atlantic Refining Co. v. Public Service Com’n.*, 360 U.S. 378, 391 (1959)).
- f. The Commission has predicated landmark orders on the need to integrate significant industry changes into its regulation. See *Citizens Power & Light Corp.*, 48 FERC ¶ 61,210 (1989) (observing that the applicant “represents a relatively new type of seller in the electric power industry” and approving its “proposed market-oriented rates”); Order No. 888, at text accompanying n. 72 (“the Commission broadened its undue discrimination analysis . . . [in response to] the changing conditions in the electric utility industry, including the emergence of non-traditional suppliers and greater competition in bulk power markets.”); Order No. 1000 at PP 42–47 (summarizing deficiencies in transmission planning practices in light of industry changes and finding that reforms will ensure that transmission services are provided just and reasonable and not unduly discriminatory rates).

5. Legal implications under the FPA associated with any implementation of a carbon price set by a single state (or group of states) in a multi-state RTO/ISO market.

Response: I intended to cover this issue in previous responses.

Respectfully Submitted,

/s/ Ari Peskoe

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