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Carbon Pricing in Organized Wholesale Electricity Markets
Federal Energy Regulatory Commission
Docket No. AD20-14-000

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This statement is being submitted in response to the Federal Energy Regulatory Commission's invitation to be a speaker at its Technical Conference, "Carbon Pricing in Organized Wholesale Electricity Markets." I appreciate the Commission inviting me to participate in this important proceeding.

Background. I currently am a Fellow / Adjunct Senior Research Scholar at Columbia University's Center on Global Energy Policy. In addition, I serve as a member of the Board of Directors of the New York Independent System Operator and also have my own private legal practice and energy industry consulting firm.

From 2012 to 2018, I was Executive Vice President & General Counsel of NRG Energy, Inc., one of the largest generators and sellers of electric energy in the United States. I also was Executive Vice President & General Counsel of NRG Yield, Inc., the company's publicly-traded subsidiary that used revenue from mainly renewable assets under long-term contract to pay a reliable dividend. From 2005 to 2009, I served as General Counsel of the U.S. Department of Energy, and from 2002 to 2005 was DOE's Deputy General Counsel for Energy Policy. I also have been a partner at major law firms including Sidley Austin LLP and Wiley, Rein & Fielding.

I have been involved in the electric power industry for more than 25 years. During that time, I have handled a wide variety of electric and natural gas legal, regulatory and policy matters, as well as a number of environmental matters. This work has been done from different perspectives – as a lawyer in private practice, as a U.S. government attorney with legal and policy responsibilities, as the general counsel and an executive officer for investor-owned Fortune 500 energy companies, as a university research scholar, and as a director of an independent system operator. The views expressed today are informed by my experience from all those perspectives.

Overview. This statement is my own and is not submitted on behalf of any organization or interest. I have been asked to speak about legal considerations, and so will confine this statement to those issues. I do not intend to address whether or how carbon pricing in the organized markets or otherwise might be good environmental, social or economic policy, except insofar as those issues affect the way in which the legal or regulatory issues should be analyzed.

In considering issues surrounding carbon pricing in the FERC-jurisdictional markets, I think the Commission should focus on addressing three separate questions: What *can* you do? What *must* you do? What do you *want* to do? These are separate and distinct questions, though I believe they often are conflated, and legal questions and answers are not always separated from those of policy.

I believe FERC does have the legal authority under section 205 of the Federal Power Act to accept a filing from an ISO/RTO to integrate a state-set carbon price or carbon limit into its FERC-jurisdictional market design. The same would go for any other public utility incorporating a state-set carbon price or limit into its FERC tariff or rate. Of course the jurisdictional utility would need to demonstrate that the carbon policy was incorporated and integrated in a manner that was just and reasonable. But do the outside bounds of section 205 permit FERC to accept such a filing? I believe the answer is yes.

I also believe FERC has the authority under FPA section 206 to determine that an RTO/ISO market is unjust, unreasonable and/or unduly discriminatory with respect to how it incorporates (or not) a state-set carbon price or limit. I am aware of arguments that FERC could accept a filing with a carbon pricing mechanism under section 205 but would have no legal authority to determine that a tariff's carbon pricing mechanism or the lack thereof was unjust, unreasonable or unduly discriminatory under FPA section 206. I don't think that makes any legal sense. As the Supreme Court has said, "There is only one statutory standard for assessing wholesale electricity rates, whether set by contract or tariff – the just-and-reasonable standard."[1] Whether there is a sufficient factual basis for FERC to determine that a particular tariff or provision is unjust, unreasonable or unduly discriminatory and therefore whether FERC could act under section 206 depends on the evidentiary showing made. But would FPA section 206 and the deference afforded to an expert agency under applicable administrative law doctrine permit FERC, given the right factual showing, to determine that a tariff's treatment (or lack thereof) of state carbon pricing in connection with the sale of energy and capacity is unjust, unreasonable and/or unduly discriminatory? Again, I believe the answer is yes.

In addressing these questions below, I will discuss not only straightforward recovery of state-mandated carbon pricing in a FERC jurisdictional tariff, but also some broader questions surrounding the incorporation of lawful state environmental policies into FERC jurisdictional tariffs. The details vary by market feature or product, but I believe the legal issues and conclusions are largely the same. The FPA requires FERC to prevent undue discrimination. It does not allow or require FERC to address it in only some cases, and only if it is caused by some things but not others. And it does not call for FERC to allow, much less create, market chaos and economic harm in the name of supposedly preventing discrimination that it blames on the states or asserts it does not have the authority to address. FERC promotes the public interest and ensures just and reasonable rates by maximizing market efficiency and transparency, while recognizing the lawful role of states in establishing environmental policy and ensuring competitive market outcomes against that backdrop.

Finally, even though this technical conference is limited to "considerations related to state adoption of mechanisms to price carbon dioxide emissions," and specifically "carbon pricing approaches where a state (or group of states) sets an explicit carbon price, whether through a price-based or quantity-based approach," there are other mechanisms by which states may attempt to explicitly or implicitly address carbon. These mechanisms may include renewable portfolio or clean energy standards, renewable energy credits generally or specifically applicable to certain technologies, etc. FERC already has addressed certain matters relating to its

[1] *Morgan Stanley Cap. Grp. Inc. v. Public Util. Dist. No. 1 of Snohomish Cnty.*, 554 U.S. 527, 545 (2008).

jurisdiction over some of those mechanisms.[2] It may be appropriate for FERC to reexamine whether it has properly determined the bounds of its jurisdiction over some of those matters, because they may "affect" FERC-jurisdictional rates in a direct and significant way that FERC does not have the authority to ignore. FERC should not and cannot second-guess matters rightfully within the jurisdiction of states or other federal regulators – but similarly it has the obligation to exercise authority over the matters within the bounds of FPA sections 205 and 206, to remedy undue discrimination where it exists and to ensure consumers are not subjected to unjust and unreasonable rates and charges.

Discussion. This statement addresses whether, as a legal matter, FERC can integrate a state carbon pricing or control program into a FERC jurisdictional rate or tariff under FPA section 205 or 206, not whether doing so would be a good idea as a policy matter.[3] When it comes to climate change, I think interests on all sides of this issue sometimes may engage in right-to-left thinking – they know the conclusion they want, and then work backwards to justify that result.[4] Maybe that is fine as to policy questions, but it's not a great way of doing legal analysis. I will try to avoid doing it when addressing the legal matters below.

I recognize there is significant public and policy disagreement about what types of action are necessary or appropriate for addressing climate change and greenhouse gas emissions, which actions are effective, what policies may be cost-justified, who should pay for them and in what ways, etc. These issues are particularly complicated because of the scope of greenhouse gas matters and the need for national and global action in order for climate change effectively to be addressed. However, none of those policy issues need to be decided in order to address the threshold question of what legal authority exists under the Federal Power Act to integrate a state-set carbon pricing or control policy into a FERC-jurisdictional tariff or rate.

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[2] *See WSPP Inc.*, 139 FERC ¶ 61,061 (2012) (FERC has jurisdiction over sales of renewable energy credits (RECs) when bundled with a jurisdictional sale of power, but does not have jurisdiction over the sale of unbundled RECs because they do not constitute the transmission or sale of electric energy); *Edison Elec. Inst.*, 69 FERC ¶ 61,344 (1994) (FERC has jurisdiction over the sale of emissions allowances if made along with the sale of electric energy).

[3] Whether the Federal Power Act authorizes FERC to accept a filing that incorporates carbon pricing as a term or condition in the tariff is not a result compelled by or even legally related to an issue that has received a fair amount of regulatory and public attention in recent years – that is, whether FERC can or must assess greenhouse gas emissions or climate-related impacts pursuant to the National Environmental Policy Act. NEPA is a procedural statute and neither imposes nor authorizes FERC to impose emissions limits or other substantive environmental requirements. Judicial decisions such as *Sierra Club v. FERC*, 867 F.3d 1357, 1373 (D.C. Cir. 2017), relating to whether and how FERC must assess greenhouse gas emissions in the context of NEPA reviews for natural gas pipeline certificates, are irrelevant to what authority the Commission has under FPA sections 205 and 206.

[4] In this regard, I'll note what former Dean of the Boston University School of Law and prominent administrative law expert Ronald A. Cass wrote about the Supreme Court's ruling that the Clean Air Act authorized EPA to regulate greenhouse gas emissions:

> Every so often, the Supreme Court renders a decision that is difficult to separate from the politics of the day… *Massachusetts v. EPA* is just such a decision. In their eagerness to promote government action to address global warming, the Justices stretch, twist and torture administrative law doctrines to avoid the inconvenient truth that this is not a matter on which judges have any real role to play. Wasting no time in signaling the politics of this decision, Justice John Paul Stevens, writing for the Court, begins his opinion with a jeremiad on global warming…. The rest, as they say, is mere detail. Unfortunately for administrative law, quite a few legal obstacles did stand in the way. Watching the Stevens opinion go around, over, and through these doctrines is both entertaining and depressing. This essay gives only a quick tour of the carnage.

Ronald A. Cass, *Massachusetts v. EPA: The Inconvenient Truth About Precedent*, 93 VA. L. REV. 75 (2007).

It is up to legislators and regulators with relevant environmental jurisdiction to decide what sort of greenhouse gas and climate change policies are appropriate, effective and cost-justified. FERC is not that regulator. Rather, Congress, the EPA and appropriate state and local officials have the authority and jurisdiction to establish carbon policy and carbon limits. And so, unless and until Congress or appropriate federal environmental agencies take national action to establish federal carbon policy that preempts state law either through conflict preemption or occupy-the-field preemption, state and local officials can decide what climate change and greenhouse gas control policies are appropriate and cost-justified.

If it has the FPA jurisdiction to do so, I think FERC should and likely must accommodate those policies. It is *not* up to FERC to decide whether state climate change policies are a good idea – or what is the socially desirable amount of carbon emissions, or whether particular amounts of carbon control are cost-justified, etc.[5] It *is* up to FERC, however, to ensure just, reasonable and not unduly discriminatory rates for wholesale sales of electric energy and the interstate transmission of electric energy. Accommodating lawful state environmental policies would help accomplish that statutory mandate.[6] In fact, I think it may well be arbitrary, capricious and an abuse of discretion – in other words, a violation of the Administrative Procedure Act[7] – for FERC *not* to do that.

And so, what legal authority does FERC have to incorporate state carbon pricing policy? In answering that question, the first place to look is the words of the statute giving FERC its jurisdiction and authority. This is what it says:

> All rates and charges made, demanded, or received by any public utility for or in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.[8]

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[5] *See Grand Council of Crees v. FERC*, 198 F.3d 950, 956 (D.C. Cir. 2000).

[6] Of course, it is important to recognize that there are state environmental policies, and then there are policies with environmental patina but that are actually directed at something else – perhaps simply overriding a properly-established FERC just and reasonable rate. The Supreme Court has made clear that states may not take measures "aimed directly" at the matters within FERC jurisdiction and seek to override FERC's actions. *See Hughes v. Talen Energy Mktg., LLC*, 578 U.S. ___, 136 S. Ct. 1288, 1298 (2016). Therefore FERC is not obliged to accommodate state actions that "aim directly" at simply second-guessing and overriding FERC decisions as to what rates, terms and conditions are just and reasonable. In *Hughes*, the Court held that the State of Maryland could not authorize a "contract for differences" which had the purpose and effect of setting a different rate for a wholesale sale of energy than the one set through the FERC jurisdictional tariff – even though the state program was nominally about encouraging the development of more generation in the state, and matters concerning what generation should be built generally are within a state's authority. Strong arguments can be made both ways about the legality of zero emission credits under the *Hughes* precedent, but the Second and Seventh Circuits both held that the states had acted within their proper scope of authority in enacting those credits. *See Coal. for Competitive Elec. v. Zibelman*, 906 F.3d 41 (2d Cir. 2018), *cert. denied*, 139 S. Ct. 1547 (2019); *Elec. Power Supply Ass'n v. Star*, 904 F.3d 518 (7th Cir. 2018), *cert. denied*, 139 S. Ct. 1547 (2019). Under those decisions and certainly under a more generator-neutral and broad-based state carbon pricing policy, states should be viewed as acting in their scope of authority, and a proper exercise of FERC jurisdiction would accommodate that state action not attempt to defeat it.

[7] 5 U.S.C. 551, *et seq*. ("APA").

[8] 16 U.S.C. 824d(a) (FPA section 205(a)).

It also says:

> No public utility shall, with respect to any transmission or sale subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.[9]

And furthermore:

> Whenever the Commission, after a hearing held upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order.[10]

These authorities sound, and in fact are, very broad. Whether FERC *must* exercise these authorities to reach certain conduct and matters, and the ways in which it *wants* to assert this authority as a matter of policy or an exercise of discretion are, as noted above, not the same question as whether FERC *can* assert authority – that is, whether doing so would be within the outer limits of FERC's jurisdiction under FPA sections 205 and 206.

The FPA vests in FERC jurisdiction over wholesale sales of electric energy.[11] The text of FPA section 205 makes clear that the domain of FERC's authority is with respect to "rates and charges" that are "for or in connection with" the transmission or sale of electric energy. And it has jurisdiction over all of the "rules and regulations affecting or pertaining to such rates," with the caveat the courts have imposed that the matters "directly" affect rates or terms of service.

The FPA not only gives FERC authority over these matters, it gives the agency "exclusive jurisdiction."[12] "'The FPA leaves no room either for direct state regulation of the prices of interstate wholesales or for regulation that would indirectly achieve the same result.'"[13] The Supreme Court has recognized that FERC "undertakes to ensure 'just and reasonable' wholesale rates by enhancing competition."[14]

A good argument can be made that the plain language of section 205 coupled with the precedent of cases such as *Hughes* and *EPSA* answers the question of whether it is permissible for an ISO/RTO tariff to accommodate within its market design and rate-setting structure state carbon pricing and carbon control policy. So long as the carbon price is incorporated as a "rate or

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9 16 U.S.C. 824d(b) (FPA section 205(b)).
10 16 U.S.C. 824e(a) (FPA section 206).
11 *Hughes*, 578 U.S. at ___, 136 S. Ct. at 1292.
12 *Id.* at 1297.
13 *Id.* (quoting *FERC v. Elec. Power Supply Ass'n. ("EPSA")*, 577 U.S. ___, 136 S. Ct. 760, 780 (2016)).
14 *EPSA*, 577 U.S. at ___, 136 S. Ct. at 768.

charge" – which it certainly would or could be – is "for or in connection with" a jurisdictional transmission or sale of electric energy, and reasonably enhances competitive market outcomes, I believe such a rate or charge is within FERC's FPA section 205 jurisdiction and can be included within an ISO/RTO tariff and market design.

FERC already has determined – correctly in my view – that it has jurisdiction over and that it is legally permissible for a FERC-jurisdictional tariff to provide for wholesale sales of energy or interstate transmission of energy transactions that include state-created renewable energy credits,[15] emissions allowances,[16] and recovery of costs relating to greenhouse gas allowances such as those pursuant to the Regional Greenhouse Gas Initiative ("RGGI").[17] Moreover, FERC has said that "we find that it is reasonable to incorporate the emissions costs of the greenhouse gas allowances into the calculation of generating units' variable costs" that are recoverable under a FERC-jurisdictional tariff.[18] And, the Commission has done that even though it did not assert jurisdiction over the establishment of the allowance costs themselves – leaving that to the authorities with environmental jurisdiction. It is only an incremental additional step to determining that an ISO/RTO rate design may incorporate a price for carbon in recognition of a state-established carbon control program. As long as the adoption of such a scheme is "all about, and only about, improving the wholesale market,"[19] I believe it falls within the scope of FERC's jurisdiction under Sections 205 and 206. There are fine lines to be drawn here, I know. But it is possible to draw them, and to do it in a manner that promotes consumer welfare, competitive markets and a proper accommodation of the jurisdiction of both federal and state agencies.

In fact, I think this result may be compelled by law. FERC obviously is under no obligation to regulate around or accommodate state policies or mandates that intrude into areas of exclusive FERC jurisdiction.[20] But having permitted the recovery of costs relating to many state-created environmental programs and mandates, I believe it would be difficult for FERC to rationally – and thus in compliance with the APA's arbitrary and capricious standard – distinguish its authority over those kinds of charges from the authority to incorporate into a FERC tariff and market design imposition of state-mandated carbon prices.

The various precedents I have seen cited in arguments about why section 205 might *not* permit such tariff provisions are, to me, inapposite. *NAACP v. FPC*[21] upheld the Federal Power Commission's determination that it had no jurisdiction under the FPA to promulgate a rule concerning equal employment opportunity and nondiscrimination because "'the purposes of the Natural Gas and Federal Power Acts are economic regulation of entrepreneurs engaged in resource developments. So considered, we do not find the necessary nexus between those

[15] *WSPP Inc.*, 139 FERC ¶ 61,061 (2012).
[16] *Edison Elec. Inst.*, 69 FERC ¶ 61,344 (1994).
[17] *See National Grid Generation LLC*, 143 FERC ¶ 61,163 (2013) (accepting for filing a cost-based power sales contract that included recovery of RGGI costs incurred by the seller); *PSEG Power Connecticut LLC*, 127 FERC ¶ 61,023 (2009) (affirming prior ruling that Regulatory Must Run Agreements may include costs of CO_2 allowances).
[18] *Cal. Indep. Sys. Operator Corp.*, 141 FERC ¶ 61,237 at P 29 (2013).
[19] *EPSA*, 136 S.Ct at 776.
[20] *Hughes*, 578 U.S. at ___, 136 S. Ct. at 1298-99, 1298 n. 11.
[21] 425 U.S. 662 (1976).

aspects of our economic regulatory activities and the employment procedures of the utility systems which we regulate, as would justify [adopting petitioners' proposed rule.]'"[22]

While upholding the FPC's determination that its jurisdiction did not extend to issuing a rule directing or prohibiting certain employment practices, the Court said that the FPC "clearly has the duty to prevent its regulatees from charging rates based upon illegal, duplicative, or unnecessary labor costs," and therefore would clearly be within its authority to disallow the recovery of costs due to discriminatory employment practices.[23] So in sum, the Court said that the FPC and its "public interest" and "just and reasonable" statutory authorizations did not empower the Commission to issue rules mandating nondiscriminatory employment practices, but they *did* authorize the FPC to regulate the recovery or non-recovery of costs relating to employment practices. In regulating the monetary consequences of activities that themselves were not subject to direct regulation by the Commission, the Court said the agency would be carrying out the "principal purpose" of the Act, which was "to encourage the orderly development of plentiful supplies of electricity and natural gas at reasonable prices."[24]

By analogy to the current situation, it seems clear that the Federal Power Act does not in the first instance authorize FERC to be an environmental regulator, or to determine what amount of emissions (greenhouse gases or any other type) from electric generating facilities may or may not be permissible or desirable in order to accomplish particular environmental objectives. FERC has neither the authority nor the expertise to determine the environmentally appropriate level of greenhouse gas emissions from electric generating facilities. Indeed, such matters would seem to fall precisely within the jurisdiction of other federal or state agencies (such as the Environmental Protection Agency under the Clean Air Act or states under their environmental authorities and the authority reserved to them by the FPA over generation facilities[25]). However, *NAACP* stands for the proposition that FERC *does* have authority over – and in fact has the statutory obligation to exercise jurisdiction over – tariffs, bilateral contracts and market designs that put into economic terms the consequences of state policy, including carbon pricing, in connection with jurisdictional power sales or transmission.

Similarly, *California Indep. Sys. Operator Corp. v. FERC*,[26] which I have seen cited as potentially casting doubt on FERC jurisdiction over a tariff term that incorporates state carbon pricing and control policy, not only does not cast such doubt, I think it actually supports FERC jurisdiction over such terms. The court held that FERC's jurisdiction over "practices" "affecting" a jurisdictional rate did not empower the Commission to "reform completely" the governance structure of a public utility (in that case the California ISO). While the case certainly says there are limits to FERC's "affecting" jurisdiction, the Court held that FERC's authority to assess the justness and reasonableness of practices affecting rates of public utilities includes "those methods or ways of doing things on the part of the utility that directly affect the rate or are closely related to the rate."[27] It is hard to think of anything more directly tied to or directly

[22] *Id.* at 664.
[23] *Id.* at 668.
[24] *Id.* at 670.
[25] *See* 16 U.S.C. 824 (FPA section 201) (FERC "shall not have jurisdiction, except as specifically provided in this subchapter and subchapter III of this chapter, over facilities used for the generation of electric energy…").
[26] 372 F.3d 395 (D.C. Cir. 2004).
[27] *Id.* at 403.

affecting "the rate" than a charge applied to or resulting from the generation of energy itself – whether it is a cost for fuel, capital investment, operations and maintenance, or carbon emissions.

That FERC-jurisdictional ISO/RTO tariffs and wholesale market designs have not previously included mechanisms to incorporate state-set carbon policies beyond simple emissions trading schemes says nothing about whether FERC has jurisdiction over those matters. The FPA permits and in fact requires FERC to adapt to changing circumstances in the electric industry, both in accepting filings under section 205 and mandating changes under section 206. As the Commission has said, "'[O]ur authorities under the FPA not only permit us to adapt to changing economic realities in the electric industry, but also require us to do so, as necessary to eliminate undue discrimination and protect electricity consumers.'"[28] FERC's transition from cost of service regulation to market-based regulation of jurisdictional power sales in the 1980s and 1990s was a sea change in the way the industry was regulated. It was a completely different way of regulating than had been in place when the FPA was enacted in 1935 and for decades after that. And, the change occurred without any specific Congressional authorization for market-based rates. Yet both FERC and the Supreme Court have determined this was just fine as a legal matter.[29]

For all these same reasons, I believe FERC has jurisdiction not only under FPA section 205 to accept a tariff filing that incorporates a state-mandated carbon policy, but also to find a tariff or rate unjust, unreasonable and/or unduly discriminatory under FPA section 206 because it does not adequately recognize and address the costs of complying with state carbon pricing or control regimes. I do not see any basis in the law for it to be permissible for a public utility to file a tariff under section 205 that integrates such carbon pricing or regulation in its rate design, and yet for FERC not to have the jurisdiction under section 206 to find the presence or absence of such terms, or their application, unjust, unreasonable or unduly discriminatory if a sufficient factual showing is made.[30]

In fact, I believe section 206 can require FERC to act to ensure that federal and state exercises of jurisdiction are harmonized in the public interest. When states act within the scope of their lawful authority to pursue climate policies, it is not consistent with, and certainly not required by, the Federal Power Act for public utilities, investors, or the consumers who pay for all of this, to endure the chaos of FERC-approved tariffs that do not take account of the reality of state carbon control policies.[31] The failure of federal and state policies to be harmonized and accommodated

[28] *New York v. FERC*, 535 U.S. 1, 33-34 (Thomas, J., dissenting in part) (quoting FERC, Order No. 888-A, Promoting Wholesale Competition Through Open Access, 78 FERC 61,222, 61,232, 62 Fed. Reg. 12,274, 12,275).
[29] *See infra* at 5 & n.14.
[30] I recognize that different factual showings must be made under FPA sections 205 and 206, and that a rate or market design could be just and reasonable under section 205, while at the same time a sufficient showing had not yet been made that would allow FERC to mandate that design under section 206, since in order to take action under 206 a showing first must be made that an existing rate, term or condition is unjust, unreasonable or unduly discriminatory. My view that FERC has legal authority, and a potential legal obligation, to ensure that jurisdictional tariffs appropriately address state carbon pricing under section 206 pertains to threshold questions of legal authority, not to the fact-specific question of whether any particular existing ISO/RTO tariff is unjust and unreasonable in light of current or potential state carbon pricing or control policies.
[31] FERC should exercise its legal authority and discretion in a way to ensure no one could say, paraphrasing Mayor Richard J. Daley, "Gentlemen, let's get the thing straight, once and for all. The FERC isn't there to create disorder, the FERC is there to preserve disorder."

results in market inefficiencies that cause consumers to pay more than they should and also hurts public utilities and investors. This is the antithesis of what competitive markets were supposed to accomplish.[32] A FERC-jurisdictional market that prices carbon in order to recognize and incorporate state carbon control policies could be an effective, economically efficient, pro-competitive and consumer-friendly way of bringing order out of this chaos. And all of this is within FERC's jurisdiction and authority under the FPA to do.

Unless and until the federal government asserts preemptive jurisdiction over the pricing of carbon, the states can – and have demonstrated that they will – seek to control and price carbon in various ways. In my view, it would not be consistent with FERC's responsibility to ensure just and reasonable rates and to serve consumer interests for it to interpret the FPA not to permit an ISO/RTO tariff and market design to incorporate state carbon pricing and policy. Forcing public utilities and their customers to deal with chaotic and costly disconnects between FERC-regulated tariffs and lawful state public policies is not the right way to run a just and reasonable wholesale energy market, nor is it consistent with reasoned decision-making under the APA.

Once FERC determines it is permissible for a jurisdictional tariff to reflect state carbon control mechanisms, there of course will be fact-specific legal questions concerning how exactly carbon pricing can be incorporated in a way that is just, reasonable, and not unduly discriminatory. In that regard, under *Chevron USA Inc. v. Nat. Res. Def. Council*, *Inc.*,[33] the courts must defer to an agency's reasonable interpretation of an ambiguous statute, and FERC has wide – though not complete – discretion how it applies the statutory standards in FPA sections 205 and 206. I will offer just a few thoughts on potential legal and administrative considerations as FERC evaluates how state carbon control policies might be integrated within a jurisdictional tariff or rate.

To the extent that public utilities incur legally required costs relating to state-mandated carbon pricing or control policies, it would seem that it would be just and reasonable for a jurisdictional market design to provide a mechanism for the pricing and recovery of those costs. Carbon costs, whether emissions-related or incurred in connection with broader attempts to price carbon imports into a state (as PJM is currently considering), are not costs of "illegal" conduct such that they might be deemed unrecoverable under the reasoning of the *NAACP* decision. Rather, they are simply costs assigned to attributes of certain types of generation, which could be incorporated in a just and reasonable manner through the auction-based system of an organized FERC-jurisdictional market.[34] The fact that including these costs within offers submitted to the wholesale energy or capacity markets could increase the market clearing price would be nothing more than the natural consequence of *any* environmental restriction that raises the price of energy or restricts its supply – which goes on every day and has since the advent of environmental regulation in the United States decades ago. This isn't exactly a new or innovative concept.[35]

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[32] *See* FERC, Order No. 888, Promoting Wholesale Competition Through Open Access, 75 FERC ¶ 61,080, 61 Fed. Reg. 21,540 (FERC ordered open access transmission "to remove impediments to competition in the wholesale bulk power marketplace and to bring more efficient, lower cost power to the nation's electricity consumers.").
[33] 467 U.S. 837, 842 (1984).
[34] *Id.* at 1293-94 (describing the PJM auction mechanisms).
[35] *See infra* at 6 & nn. 15-19.

In addition, that incorporation of state carbon control policy through a carbon price likely would result in some FERC-jurisdictional energy and capacity being priced differently than other energy and capacity does not mean that the price differences are unjust, unreasonable or unduly discriminatory. Decisions as to whether and where to permit energy generation facilities – which the states have the authority to make – always have an effect on FERC-jurisdictional capacity and energy prices. And they result in different prices being paid to different generators (sometimes generators of exactly the same type) through operation of the FERC-jurisdictional markets, congestion pricing, and locational marginal pricing regimes. FERC and the courts have determined that such incidental rate impacts are just fine as a legal matter. [36]

Multi-state ISO/RTO markets may present difficult legal or practical issues as to exactly how state-mandated carbon policies can be incorporated into a market design in a manner that is just and reasonable. But I don't think doing so is beyond the ingenuity of the human mind, or beyond the scope of what is permissible in a just, reasonable and nondiscriminatory rate.

When a state places a price on carbon imports or otherwise acts to incentivize low or zero emitting resources and penalize emitting resources, the state policy likely will have the effect in the short run of limiting supplies of energy and increasing market clearing prices in organized markets. But as has been observed in a number of markets, increased penetration of low or zero carbon emitting resources, which often have low or zero marginal costs, can drive energy prices to levels even below zero. Moreover, net carbon pricing regimes that incorporate lawful state policy by redistributing carbon costs to consumers or to low or zero emitting producers also may have little or no net economic effect on consumers overall, even though they reasonably and rationally may disadvantage some generators and benefit others, consistent with law.

There will be matters of degree as to what amounts of interstate price impacts are just and reasonable in the context of a multi-state ISO/RTO as a result of any particular state's imposition of a carbon pricing or control regime, and its integration into an ISO/RTO market design. But the mere fact that a state's carbon regime could result in increased costs/prices in other states does not in itself mean that the impacts are unjust, unreasonable or unduly discriminatory. The necessary result of an interconnected transmission grid (and a multi-state ISO/RTO) is that decisions about what generation (or consumption) occurs in any one state may have an effect on the availability and price of energy in other states. That there are some interstate impacts from a particular state's carbon pricing mechanism should be fine as a legal matter and could be determined to be just, reasonable and nondiscriminatory, so long as the impact is incidental and the state imposing the carbon price (which has been incorporated into the FERC jurisdictional tariff) has not targeted its carbon pricing in a manner to unduly discriminate against and particularly disadvantage out of state producers or consumers.

In the end, incorporation of state carbon pricing and control policies into FERC jurisdictional rates, insofar as they would permit markets to effectively incorporate all costs being placed on producers and thus reach a more market-efficient outcome, not only is not improper, it would promote transparency, increase the efficiency of the FERC-jurisdictional markets, and help ensure consumers receive what FERC envisioned to be the promise of competitive power markets. In other contexts FERC has found efficiency not only to be a worthy and permissible

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[36] 578 U.S. ___, 136 S. Ct. 1288, 1298; *Oneok, Inc. v. Learjet, Inc.*, 575 U.S. 373, 394-95 (2015).

objective of just and reasonable rates but has provided incentive returns on equity to encourage projects that would promote objectives including efficiency and has referred to it as a "demonstrable consumer benefit."[37]

Conclusion. FERC not only can, it *must* ensure rates are just, reasonable and not unduly discriminatory. It does so by enhancing competition – and that is best done by ensuring wholesale market designs and the rates, terms and conditions of jurisdictional service take into account current circumstances with respect to energy and environmental issues, capital markets, and consumer interests. All of these things can and should be taken into consideration and balanced when determining what is a just, reasonable and nondiscriminatory rate under FPA sections 205 and 206.[38]

It serves the interests of public utilities, investors, and most importantly consumers if FERC and the states observe and accommodate what the other is properly doing within the scope of its jurisdiction. Until Congress or federal agencies with appropriate environmental jurisdiction act to price carbon in a preemptive way, the states have the authority to do so and in fact are doing so. It is within the Commission's statutory authority under the FPA to incorporate state carbon pricing and control policies into efficient, FERC-jurisdictional wholesale rates and market designs. And that's what FERC and the jurisdictional ISOs and RTOs can and should do.

[37] *See Promoting Transmission Investment Through Pricing Reform*, 141 FERC ¶ 61,129 (2012) (rule intended to encourage applicants to seek incentive rate on equity "for projects that provide demonstrable consumer benefits by making the transmission grid more efficient, reliable, and cost-effective.").
[38] *Morgan Stanley*, 554 U.S. at 532 (just and reasonable rates require balancing consumer and investor interests).