

EASING JURISDICTIONAL TENSIONS BY INTEGRATING PUBLIC POLICY IN WHOLESALE ELECTRICITY MARKETS

*Ari Peskoe**

Synopsis: This article explores FERC's authority under the Federal Power Act (FPA) to approve a wholesale market tariff that facilitates market participants' achievement of their legal obligations under renewable energy and CO₂ policies. It concludes that incorporating environmental mandates and states' generation choices in wholesale markets is consistent with the law and allows states in RTO regions to continue to meaningfully exercise their historic authority over generation facilities.

Decades of FERC orders and federal court decisions emphasize that FERC's authority under the FPA is adaptable in response to industry changes. Integrating renewable energy and carbon policies into wholesale markets is similarly responsive to industry trends, and FERC's approval of a wholesale market tariff that incorporates public policy goals is consistent with the generous construction of the FPA afforded by courts. The FPA's just and reasonable standard, now tied to enhancing competition, as well as the statute's core purposes of consumer protection and industry development, connect FERC's authority to market-based compliance with energy and environmental mandates. Once FERC establishes a nexus between wholesale rates and public policy compliance and concludes that facilitating compliance through markets is consistent with its statutory duties, courts will be reluctant to cut off FERC's jurisdiction.

This article uses proposals considered in the NEPOOL stakeholder process known as Integrating Markets and Public Policy (IMAPP) as case studies. Participants in the New England markets have discussed ISO-NE procurement mechanisms for zero-emission energy or capacity and pricing carbon in energy markets. While legal precedent is not definitive, FERC approval of an IMAPP proposal is justifiable and defensible. Nonetheless, IMAPP proposals present a few legal questions that have not been addressed by FERC or courts and that are potentially fatal to FERC's approval.

This article addresses three threshold questions: (1) does IMAPP amount to impermissible regulation of state-regulated generation facilities; (2) may FERC approve market mechanisms that are premised in part on state policies; and (3) do IMAPP proposals unduly discriminate against emitting resources? Concluding that these issues do not prevent FERC from approving an IMAPP proposal as just and reasonable, the article then discusses the proposed mechanisms and finds that

* Ari Peskoe is the Senior Fellow in Electricity Law at Harvard Law School's Environmental Policy Initiative. I would like to thank David Bono, Matthew Christiansen, Danny Cullenward, Michael Panfil, Howard Peskoe, Matthew Price, Dan Watkiss, and Shelley Welton for helpful comments on earlier drafts. All conclusions and errors are my own.

procurement mechanisms present fewer legal and political vulnerabilities than pricing CO₂ emissions. Ultimately, if FERC concludes that IMAPP will result in just and reasonable rates, courts will be deferential to FERC's policy and technical judgments that support its determination.

Finally, this article discusses how a FERC-jurisdictional tariff that facilitates achievement of public policies might interact with state law. A FERC-jurisdictional market mechanism designed to facilitate compliance with state policy goals would provide a framework for restructured states to effectuate environmental and generation policies while respecting FERC's exclusive and flexible authority over wholesale rates. Many existing policies, such as renewable portfolio standards, do not prevent utilities from complying through an RTO mechanism, and future state policies could explicitly allow for achievement through a regional market. Facilitating the achievement of public policies with federally regulated markets has the potential to transform the relationship between state policy and the Federal Power Act.

I.	The Flexibility of the Federal Power Act.....	3
A.	Market-Based Competition Under a Cost-of-Service Era Statute	3
B.	The Just and Reasonable Standard and FERC Review of RTO Tariffs	7
C.	Integrating Markets and Public Policy is Just and Reasonable and Consistent with the FPA's Ultimate Purposes	12
II.	Case Study: NEPOOL's Integrating Markets and Public Policy Process	15
A.	Are IMAPP Proposals Unambiguously Prohibited by FPA Section 201 Because They Regulate Generation Facilities?.....	17
B.	May FERC Approve Tariff Provisions That Are Premised in Part on Public Policy?.....	19
C.	Do IMAPP Proposals Unduly Discriminate Against Emitting Resources?	23
D.	Analysis of Specific IMAPP Proposals.....	26
1.	Reforming the Forward Capacity Market (FCM)	26
2.	Including a Carbon Adder in Energy Markets	30
3.	Creating a Forward Clean Energy Market (FCEM)	37
III.	Interaction with State CO ₂ and Renewable Energy Laws.....	38
A.	Shifting Implementation of State Policy Under the FPA	38
B.	Would FERC-jurisdictional Procurement Mechanisms Preempt Renewable Portfolio Standards or Other State Procurement Mandates?.....	40
C.	Would an RTO Carbon Adder Preempt RGGI or Other State CO ₂ Policies?	43
D.	May States "Retain Full Control" Over the Implementation of an RTO Tariff Provision?	44
E.	Must a FERC-jurisdictional Tariff Premised on State or Federal Policies be Strictly Limited to Identifiable Laws and Regulations?.....	46

IV. Conclusion 48

I. THE FLEXIBILITY OF THE FEDERAL POWER ACT

A. *Market-Based Competition Under a Cost-of-Service Era Statute*

Under section 201 of the FPA, FERC has exclusive jurisdiction over “the transmission of electric energy in interstate commerce” and “the sale of electric energy at wholesale in interstate commerce.”¹ Sections 205 and 206 provide FERC with its primary task under the statute—ensuring that all jurisdictional rates are “just and reasonable.”²

The core provisions in sections 201, 205, and 206 are virtually unchanged since Congress passed Title II of the FPA in 1935. Yet FERC has applied the FPA in novel ways; its current market-based regulatory regime bears little resemblance to the cost-of-service ratemaking it has always administered. Section 201’s capacious jurisdictional language and the flexible standards in sections 205 and 206 have enabled FERC to respond to industry shifts.³

From 1935 until the 1980s, FERC regulated wholesale sales of electricity exclusively on a cost-of-service basis. Pursuant to section 205, wholesale sellers of energy submitted to FERC rates that provided for cost recovery plus a rate of return sufficient to attract necessary capital.⁴ Parties could also negotiate contracts, and FERC would review them based on cost-of-service principles.⁵

Beginning in the late 1980s, FERC shifted from cost-of-service to market-based regulation of wholesale electricity sales.⁶ Rather than filing specific rate

1. 16 U.S.C. § 824(b) (1978); *Hughes v. Talen*, 136 S. Ct. 1288, 1291 (2016); *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 966 (1986).

2. 16 U.S.C. § 824d(a).

3. *See, e.g., Richmond Power & Light v. FERC*, 574 F.2d 610 (D.C. Cir. 1978) (upholding FERC’s response to the 1970s energy crisis in a ratemaking proceeding); *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988); *Jersey Cent. Power & Light Co. v. FERC*, 810 F.2d 1168 (enabling nuclear cost recovery through FERC-jurisdictional rates when cost recovery of nuclear plants was a controversial issue for numerous utilities); *Transmission Access Policy Grp. v. FERC*, 225 F.3d 667 (D.C. Cir. 2000), *aff’d* *New York v. FERC*, 535 U.S. 1 (2002) (upholding FERC’s open-access order); *FERC v. Elec. Power Supply Ass’n*, 136 S.Ct. 760 (2016) (upholding FERC’s demand response pricing order). *See also In re Permian Basin Area Rate Cases*, 390 U.S. 747, (1968) (upholding FERC’s two-priced rate structure under the Natural Gas Act (NGA)); *Associated Gas Distribs. v. FERC*, 824 F.2d 981 (1987) (largely upholding the unbundling order under the NGA). The FPA itself was passed in part as a reaction to the financial collapse of the late 1920s/early 1930s and with the recognition that an industry that had consisted of local businesses had transformed, as then Governor Roosevelt explained in 1932, “into [an] interstate business of vast proportions [that] requires [the] strict regulation and control of the federal government.” Franklin Delano Roosevelt, Governor, Campaign Address on Public Utilities and Development of Hydro-Electric Power in Portland, Ore. (Sept. 21, 1932), <http://newdeal.feri.org/speeches/1932a.htm>.

4. *FPC v. Hope Nat. Gas Co.*, 320 U.S. 591 (1944).

5. *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956).

6. *California ex rel. Lockyer v. FERC*, 383 F.3d 1006, 1012 (9th Cir. 2004).

However, approximately a decade ago, companies began to file market-based tariffs that did not specify the precise rate to be charged. As a result, FERC then departed from its historical policy of basing

schedules or contracts based on costs, sellers request from FERC authority to sell energy at market-based rates. FERC approves a seller's market-based rate authority so long as it concludes that the seller cannot exercise market power.⁷ Market-based rate authority frees a seller from review under cost-of-service regulation and allows it to sell energy into wholesale auction markets and through bilateral contracts at negotiated rates. Although Congress did not provide FERC any specific authorization in the FPA to allow for approval of market-based rates, FERC concluded that rates that are freely negotiated by sophisticated market participants would meet the FPA's just and reasonable standard. As the D.C. Circuit explained, "[i]n a competitive market, where neither buyer nor seller has significant market power, it is rational to assume that the terms of their voluntary exchange are reasonable."⁸

Once it established market-based rates,⁹ FERC then sought additional means to encourage and facilitate the growth of competitive wholesale markets for electricity.¹⁰ In 1996, it concluded that transmission owners' unduly discriminatory practices motivated by their incentives to stifle competition presented a "persistent barrier" to the development of competitive markets.¹¹ Pursuant to its authority under sections 205 and 206, FERC ordered all jurisdictional transmission owners to file open-access tariffs that provide competitors with the same transmission services as the owners provide for themselves.¹² In reviewing FERC's order, the D.C. Circuit concluded that the FPA's "ambiguous antidiscrimination provisions . . . giv[e] [FERC] broad authority to remedy unduly discriminatory behavior."¹³

With "the foundation necessary for competitive wholesale markets" in place, FERC concluded that the "traditional management of the transmission grid by vertically integrated electric utilities was inadequate to support the . . . development

rates upon the cost of providing service plus a fair return on invested capital, and began approving market-based tariffs. *Id.*

7. FERC initially defined market power as a seller's ability to "significantly influence price in the market by withholding service and excluding competitors for a significant period of time." *Citizens Power & Light Corp.*, 48 F.E.R.C. ¶ 61,210 at 61,777 (1989).

8. *Tejas Power Corp. v. FERC*, 908 F.2d 998, 1004 (D.C. Cir. 1990).

9. The Supreme Court has never ruled on whether market-based rates are legal under the FPA. In *Morgan Stanley*, the Court "reiterate[d] that we do not address the lawfulness of FERC's market-based-rates scheme, which assuredly has its critics," and invited challengers to address that issue in a separate case. *Morgan Stanley Capital Grp Inc. v. Pub. Util. Dist. No. 1 of Snohomish Cty.*, 554 U.S. 527, 548 (2008). In 2011, the Ninth Circuit rejected a broad challenge to FERC's market-based regulatory scheme. *Montana Consumer Counsel v. FERC*, 659 F.3d 910 (9th Cir. 2011), *cert. denied*, 133 S. Ct. 26. The Court's most recent cases about the Federal Power Act do not address challenges to market-based rates.

10. See Notice of Proposed Rulemaking, *Recovery of Stranded Costs by Pub. Utils. and Transmitting Utils.*, 59 Fed. Reg. 35,274 (1994) (to be codified at 18 C.F.R. pt. 35) ("Our goal is to facilitate the development of competitively priced generation supply options, and to ensure that wholesale purchasers of electric energy can reach alternative power suppliers and vice versa.").

11. Order No. 888, *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Servs. by Pub. Utils.*, 75 F.E.R.C. ¶ 61,080 (1996).

12. *Transmission Access Policy Grp.*, 225 F.3d at 684; see also 75 F.E.R.C. ¶ 61,080 at P 50 ("Non-discriminatory open access to transmission services is critical to the full development of competitive wholesale generation markets and the lower consumer prices achievable through such competition.").

13. *Transmission Access Policy Grp.*, 225 F.3d at 687.

of competitive electricity markets.”¹⁴ Therefore, pursuant to its authorities under sections 205 and 202(a)¹⁵ to promote and encourage regional interconnection and coordination of transmission facilities, FERC established minimum standards for Regional Transmission Operators (RTOs) that would operate the transmission grid in support of competitive regional markets. Meanwhile, FERC approved agreements among utilities filed under section 205 that established RTOs and rules for energy and capacity auction markets.¹⁶

FERC facilitated this industry restructuring without any explicit authorization from Congress.¹⁷ It allowed for market-based rates, mandated open-access transmission, approved utility-created RTOs, and reviewed rules for spot-market auctions, all pursuant to a statute that was written for a different regulatory regime. Given that FERC facilitated the creation of these markets without specific Congressional authorization, it stands to reason that FERC may approve modifications to those market rules, provided that those modifications result in just and reasonable rates that are not unduly discriminatory.

A limiting principle to that authority is that FERC is likely prohibited from approving a tariff provision that covers non-jurisdictional activity.¹⁸ In *Detroit Edison*, the D.C. Circuit held that FERC approval of an RTO tariff that allowed unbundled retail customers to take distribution service under the tariff exceeded FERC’s authority because FERC did not have jurisdiction over unbundled retail distribution service.¹⁹ The decision concluded that FERC was unable to “harmonize its orders with the statutory limits on its jurisdiction.”²⁰ Under *Detroit Edison*, a market mechanism that is not within FERC’s jurisdiction may not be included in an RTO tariff. So, for example, FERC may not regulate under the FPA “markets in all electricity’s inputs—steel, fuel, and labor most prominent among them.”²¹

14. Order No. 2000, *Regional Transmission Organizations*, 89 F.E.R.C. ¶ 61,285 (1999); see also *Midwest Transmission Owners v. FERC*, 373 F.3d 1361, 1364 (D.C. Cir. 2004) (“In FERC’s view, inefficiencies in the transmission grid and lingering opportunities for transmission owners to discriminate in their own favor remained obstacles to robust competition in the wholesale electricity market.”).

15. 16 U.S.C. § 824a(a).

16. See, e.g., *PJM Interconnection*, 81 F.E.R.C. ¶ 61,257 (1997) (concluding that the “proposed locational marginal pricing (LMP) model, in conjunction with the use of FTRs, is just and reasonable”).

17. FERC’s wheeling authority under §§ 211 and 212 allow FERC to require a transmission owner to wheel power on a case-by-case basis. FERC “aggressively implemented” these sections to “facilitate the development of competitively priced generation supply options, and to ensure that wholesale purchasers of electric energy can reach alternative power suppliers and vice versa.” *Transmission Access Policy Grp.*, 225 F.3d at 682. However, FERC ultimately concluded that its wheeling authority “would not remedy the fundamentally anti-competitive structure of the transmission industry” and did not rely on this authority in its open-access order. *Id.* at 684.

18. *Detroit Edison v. FERC*, 334 F.3d 48 (D.C. Cir. 2003).

19. *Id.* at 49.

20. *Id.* at 53.

21. *Elec. Power Supply Ass’n*, 136 S. Ct. at 774.

Taken for all it is worth, that statutory grant could extend FERC’s power to some surprising places. As the court below noted, markets in all electricity’s inputs—steel, fuel, and labor most prominent among them—might affect generators’ supply of power. [] And for that matter, markets in just about everything We cannot imagine that was what Congress had in mind. *Id.*

The Supreme Court's recent ruling on demand response is a useful starting point for assessing the scope of FERC's jurisdiction.²² The FPA, written in 1935, does not explicitly contemplate wholesale auction markets, let alone demand response programs in those markets that have proliferated due to advances in computing and communications technologies. Challengers to FERC Order No. 745 claimed that the Commission's demand response regulations were reaching beyond its jurisdiction into an area of state authority by effectively regulating sales of energy to end users.²³ FERC defended its assertion of jurisdiction on the grounds that demand response effectuated through wholesale market rules balances supply and demand and therefore "affects" FERC-jurisdictional rates pursuant to sections 205 and 206.²⁴ Yet, FERC conceded that demand response compensation is a "complex matter that lies at the confluence of state and federal jurisdiction."²⁵

The Court upheld FERC's assertion of jurisdiction, finding that demand response indeed "directly affects" wholesale rates.²⁶ Rejecting petitioners' arguments that FERC was intruding on state authority, the Court found that FERC aimed "to enhance the wholesale, not retail, electricity market."²⁷ And while the rule undoubtedly had effects on state-regulated retail sales, those effects were "of no legal consequence."²⁸ FERC "follow[ed] the dictates of its regulatory mission to improve the competitiveness, efficiency, and reliability of the wholesale market."²⁹

Moreover, the Court concluded that it "will not read the FPA, against its clear terms, to halt a practice that so evidently enables the Commission to fulfill its statutory duties of holding down prices and enhancing reliability in the wholesale energy market."³⁰ The Court's decision stands for the proposition that absent specific language in the FPA prohibiting FERC from regulating a particular practice,

22. *Id.*

23. Order No. 745, *Demand Response Compensation in Organized Wholesale Energy Markets*, 134 F.E.R.C. ¶ 61,187 at PP 103-111 (2011)

24. *Id.* at PP 112-115.

25. *Id.* at P 114.

26. *Elec. Power Supply Ass'n*, 136 S. Ct. at 775. A recent FERC order illustrates FERC's understanding of the scope of its authority post-*EPSA*. One month after the Supreme Court issued its decision, FERC approved a PJM tariff filing under § 205 that provides a funding mechanism for Consumer Advocates of the PJM States (CAPS). Under the approved tariff, market participants will fund CAPS based on the share of megawatt hours delivered. FERC approved the filing as just, reasonable and not unduly discriminatory and concluded "that funding CAPS is a reasonable business expense of PJM which will benefit PJM's ratepayers by 'increas[ing] its responsiveness to the needs of customers and other stakeholders.'" *PJM Interconnection*, 154 F.E.R.C. ¶ 61,147 at P 39 (2016) (citations omitted). In denying rehearing, FERC rejected arguments that its approval of the tariff funding mechanism exceeded its jurisdiction. *Id.* Citing *EPSA*, FERC explained that the PJM stakeholder process "is a practice that directly affects wholesale rates" and "provides input that directly affects the content of jurisdictional practices." *PJM Interconnection*, 157 F.E.R.C. ¶ 61,229 at PP 7-8 (2016). FERC asserted that its "jurisdiction is not limited to the direct costs of services rendered through jurisdictional assets, and CAPS funding is a legitimate business expense of PJM because it facilitates fulfillment of a PJM obligation under the PJM Operating Agreement." *Id.* at 12.

27. *Electric Power Supply Ass'n*, 136 S. Ct. at 779.

28. *Id.* at 776.

29. *Id.* at 779.

30. *Id.* at 782.

that practice is within the Commission's jurisdiction if it "directly affects" wholesale rates. When FERC determines that regulation of such a practice is also consistent with the FPA's regulatory purposes, courts defer to FERC's assertion of jurisdiction.³¹ As the Court explained decades earlier in a case about FERC's authority under the Natural Gas Act,³² "[w]e 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."³³ FERC's "broad responsibilities therefore demand a generous construction of its statutory authority."³⁴ FERC "must be permitted, consistently with obligations of due process, to adapt their rules and policies to the demands of changing circumstances."³⁵

B. *The Just and Reasonable Standard and FERC Review of RTO Tariffs*

"There is only one statutory standard for assessing wholesale-electricity rates, whether set by contract or tariff—the just-and-reasonable standard."³⁶ The Supreme Court has repeatedly reiterated that "'just and reasonable' is obviously incapable of precise judicial definition."³⁷ FERC therefore has discretion; in making determinations about just and reasonable rates "the Commission [is] not bound to the use of any single formula or combination of formulae" and may make "pragmatic adjustments."³⁸ The just and reasonable standard focuses the Commission's review on the "result reached, not the method employed" to set the rate.³⁹

The core Constitutional requirement is that determining whether a rate is just and reasonable must "involve[] a balancing of the investor and the consumer interests."⁴⁰ More generally, FERC "must be free, within limitations imposed by pertinent constitutional and statutory commands, to devise methods of regulation

31. In *Electric Power Supply Association*, the Court did not rely on *Chevron* deference to uphold FERC's jurisdiction. *Id.* at 785 (J. Scalia, dissenting). The D.C. Circuit's warning that "[w]ere courts to *presume* a delegation of power absent an express *withholding* of such power, agencies would enjoy virtually limitless hegemony, a result plainly out of keeping with *Chevron* and quite likely with the Constitution as well," is therefore inapplicable. *Ethyl Corp. v. EPA*, 51 F.3d 1053, 1060 (D.C. Cir. 1995).

32. Because the core provisions of the FPA and Natural Gas Act "are in all material respects substantially identical," *FPC v. Sierra Pac. Power Co.*, 350 U.S. 348, 353 (1956), the Supreme Court has "an established practice of citing interchangeably decisions interpreting the pertinent sections of the two statutes." *Arkansas La. Gas Co. v. Hall*, 453 U.S. 571, 576 n. 7 (1981).

33. *Permian Basin Area Rate Cases*, 390 U.S. at 780 (1968).

34. *Id.* at 776; *see also id.* at 790 ("the breadth and complexity of the Commission's responsibilities demand that it be given every reasonable opportunity to formulate methods of regulation appropriate for the solution of its intensely practical difficulties.").

35. *Id.* at 784.

36. *Morgan Stanley Capital Grp.*, 554 U.S. at 545.

37. *Id.* at 532 (citing *FPC v. Texaco Inc.*, 417 U.S. 380, 389, (1974); *Permian Basin Area Rate Cases*, 390 U.S. at 767 (1968)).

38. *Hope Nat. Gas Co.*, 320 U.S. at 602 (1944).

39. *Id.* *See also* *City of Charlottesville v. FERC*, 661 F.2d 945, 950. "Experience has taught that a determination of whether the result reached is just and reasonable requires an examination of the method employed in reaching that result.[] In examining Commission methodology, '[w]hat is basic is the requirement that there be support in the public record for what was done.'" *Id.* (citing *In re Permian Basin Area Rate Cases*), 390 U.S. at 791; *Am. Pub. Gas Ass'n v. FPC*, 567 F.2d 1016, 1029 (D.C. Cir. 1977)).

40. *Hope Nat. Gas Co.*, 320 U.S. at 603.

capable of equitably reconciling diverse and conflicting interests.”⁴¹ This understanding of ratemaking as a balancing of interests was articulated when rates were set based on cost-of-service principles, but the Court has never rejected it. To the contrary, the Court reaffirmed its relevance in a 2008 decision about FERC’s authority to modify negotiated contract rates.⁴²

As FERC has transitioned to a market-based rate regime, the Supreme Court’s understanding of ‘just and reasonable’ has evolved. In 2016, the Court observed that FERC “undertakes to ensure ‘just and reasonable’ wholesale rates by enhancing competition—attempting, as we recently explained, ‘to break down regulatory and economic barriers that hinder a free market in wholesale electricity.’”⁴³ In Order No. 745 FERC further explained that “[e]ffective wholesale competition” furthers its core mission of consumer protection⁴⁴ by “among other things, providing more supply options, encouraging new entry and innovation, and spurring deployment of new technologies.”⁴⁵

The FPA’s just and reasonable standard delegates wide discretion to FERC, and courts respect FERC’s judgment. The Supreme Court has said that courts must “afford great deference to the Commission in its rate decisions,”⁴⁶ and their “limited role is to ensure that FERC engaged in reasoned decisionmaking—that it weighed competing views, selected a compensation formula with adequate support in the record, and intelligibly explained the reasons for making that decision.”⁴⁷ “[T]hose who would overturn the Commission’s judgment undertake ‘the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences.’”⁴⁸

This judicial deference is rooted in the nature of just and reasonable determinations. It is well-established that “[i]ssues of rate design are fairly technical and, insofar as they are not technical, involve policy judgments that lie at the core of [FERC’s] regulatory mission.”⁴⁹ FERC has concluded that when it makes such policy judgments it “is not limited to textbook economic analysis of the markets

41. *In re Permian Basin Area Rate Cases*, 390 U.S. at 767.

42. *Morgan Stanley Capital Grp.*, 554 U.S. at 532 (stating that FERC must choose a ratemaking “method that entails an appropriate ‘balancing of the investor and consumer interests.’”).

43. *Elec. Power Supply Ass’n*, 136 S. Ct. at 768 (quoting *Morgan Stanley Capital Grp.*, 554 U.S. at 536).

44. 134 F.E.R.C. ¶ 61,187 at P 8; *Pa. Water & Power Co. v. Fed. Power Comm’n*, 343 U.S. 414, 418 (1952) (“A major purpose of the [FPA] is to protect power consumers against excessive prices.”).

45. 134 F.E.R.C. ¶ 61,187 at P 8; Notice of Proposed Rulemaking, *Electric Storage Participation in Markets Operated by Regional Transmission Organizations and Independent System Operators*, 157 F.E.R.C. ¶ 61,121 at P 14 (2016) (“Effective wholesale competition encourages entry and exit and promotes innovation, incentivizes the efficient operation of resources, and allocates risk appropriately between consumers and producers.”).

46. *Morgan Stanley Capital Grp.*, 554 U.S. at 532 (2008) (citing *FPC v. Texaco Inc.*, 417 U.S. 380, 389 (1974); *Permian Basin Area Rate Cases*, 390 U.S. at 767 (1968)).

47. *Elec. Power Supply Ass’n*, 136 S. Ct. at 764-765.

48. *Permian Basin Area Rate Cases*, 390 U.S. at 767 (quoting *Hope Nat. Gas Co.*, 320 U.S. at 602).

49. *Elec. Consumers Res. Council v. FERC*, 407 F.3d 1232, 1236 (D.C. Cir. 2005) (quoting *Pub. Util. Comm’n of Cal. v. FERC*, 254 F.3d 250, 254 (D.C. Cir. 2001)); see also *Elec. Power Supply Ass’n*, 136 S.Ct. at 784 (explaining that with regard to the appropriate compensation for demand response resources, the “disputed question here involves both technical understanding and policy judgment”); *Town of Norwood v. FERC*, 962 F.2d 20, 22 (D.C. Cir. 1992).

subject to [its] jurisdiction, but also may account for the practical realities of how those markets operate.”⁵⁰ In assessing whether a wholesale rate is just and reasonable, FERC “is authorized to consider the consequences” of all utility practices “insofar as such consequences are directly related to the Commission’s establishment of just and reasonable rates.”⁵¹

A just and reasonable rate must also be in the “public interest.”⁵² Public interest, “as distinguished from the private interests of the utilities,”⁵³ “is the touchstone for just-and-reasonable review.”⁵⁴ The Supreme Court has cautioned that the FPA’s public interest mandate does not provide FERC with a “broad license to promote the general public welfare”⁵⁵ but rather emphasizes that just and reasonable rates must be consistent with the statute’s “principal purpose” of “encourag[ing] the orderly development of plentiful supplies of electricity . . . at reasonable prices.”⁵⁶ The section 201 public interest mandate thus instructs FERC to

50. 134 F.E.R.C. ¶ 61,187 at P 46 (citing *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866, 872 (D.C. Cir. 1993); *Vt. Dep’t of Pub. Serv. v. FERC*, 817 F.2d 127, 135 (D.C. Cir. 1987); *Columbia Gas Transmission Corp. v. FERC*, 750 F.2d 105, 112 (D.C. Cir. 1984)).

51. *Nat’l Ass’n for Advancement of Colored People v. FPC*, 425 U.S. 662, 671 (1976) (concluding that the FPA provides the FPC with “ample authority to consider whatever evidence and make whatever inquiries are necessary to determine whether a regulatee has incurred unnecessary or illegitimate costs because of racially discriminatory employment practices”).

52. *Am. Paper Inst. v. Am. Elec. Power Serv. Corp.*, 461 U.S. 402, 417 (1983) (citing *Nat’l Ass’n for Advancement of Colored People*, 425 U.S. at 669). When FERC concludes that a rate “harms the public interest,” it “may abrogate the contract.” *Morgan Stanley Capital Grp.*, 554 U.S. at 548. The Court has explained that a jurisdictional rate may be “so low as to adversely affect the public interest—as where it might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory,” while also acknowledging that this list is not exhaustive of public interest factors. *Id.* at 548–49 (quoting *Sierra Pac. Power Co.*, 350 U.S. at 355).

53. *Morgan Stanley Capital Grp.*, 554 U.S. at 560.

54. *Id.* at 561 (J. Stevens, dissenting); see also *Sierra Pac. Power Co.*, 350 U.S. at 355 (“the purpose of the power given the Commission by § 206(a) [to remedy rates that are unjust and unreasonable] is the protection of the public interest”).

55. *Nat’l Ass’n for Advancement of Colored People*, 425 U.S. at 671 (1976).

[T]he use of the words “public interest” in a regulatory statute is not a broad license to promote the general public welfare. Rather, the words take meaning from the purposes of the regulatory legislation. In order to give content and meaning to the words “public interest” as used in the Power and Gas Acts, it is necessary to look to the purposes for which the Acts were adopted. In the case of the Power and Gas Acts it is clear that the principal purpose of those Acts was to encourage the orderly development of plentiful supplies of electricity and natural gas at reasonable prices.

Id. Title II of the FPA is littered with references to the “public interest.” FERC must consider the public interest when it evaluates major utility transactions (§ 203), security issuances (§ 204), and interconnection and wheeling requests (§§ 210, 211), and must account for the public interest in its reliability standards (§ 215), market price transparency rules (§ 220), market manipulation rules (§ 222), orders to require unregulated utilities to provide open-access transmission (§ 211A), and when it wields its limited transmission line siting authority (§ 216). These numerous references to the public interest require that FERC consider the statute’s core purposes when it makes decisions.

56. *Nat’l Ass’n for Advancement of Colored People*, 425 U.S. at 669; see also *Morgan Stanley Capital Grp.*, 554 U.S. at 561 (J. Stevens, dissenting) (explaining that public interest is “shorthand for the interest of consumers in paying the ‘lowest possible reasonable rate consistent with the maintenance of adequate service in the public interest.’”); *Permian Basin Area Rate Cases*, 390 U.S. at 793 (quoting *Atl. Ref. Co. v. Pub. Serv. Comm’n of N. Y.*, 360 U.S. 378, 388 (1959)).

ensure that just and reasonable wholesale rates advance the Commission's "ultimate purposes."⁵⁷

Although the just and reasonable standard is the same under FPA sections 205 and 206,⁵⁸ FERC plays "an essentially passive and reactive" role under section 205,⁵⁹ while under section 206 FERC must bear two burdens of proof. When FERC reviews a proposed market rule filed by an RTO under section 205, FERC's "overall task, of course, [is] to ensure, based on record evidence, that the rates and practices set forth in the [] Tariff [are] just, reasonable, and not unduly discriminatory."⁶⁰ To approve the tariff, FERC need not conclude that there is any deficiency with the current tariff or that the revision results in the optimal or best tariff.⁶¹ Any party opposing FERC's approval has "the burden . . . to show that the Commission's choices are unreasonable and its chosen line of demarcation is not within a zone of reasonableness as distinct from the question of whether the line drawn by the Commission is precisely right."⁶² A tariff filer thus enjoys dual deference under section 205. FERC is deferential to the tariff filer's proposal, and a reviewing court is likely to defer to FERC's just and reasonable determination.

Under section 206, however, in order to demand any change to an existing tariff, FERC must meet a "dual burden."⁶³ It must prove both that the existing tariff results in unjust, unreasonable, or unduly discriminatory rates and that its proposed changes are just and reasonable.⁶⁴ The Order No. 745 proceeding and subsequent litigation illustrate that requiring RTOs to modify their tariffs can be contentious and uncertain. FERC must build its case and defend it in court, while under section 205 FERC can let market participants take the lead. To be sure, a major section 205 proceeding is also likely to lead to litigation, as some market participants will be disadvantaged by a change of market rules and may choose to litigate. But proceeding under section 206 also presents unique political challenges.

In the current environment, any move by FERC to incorporate renewable energy and environmental policies in wholesale markets may be greeted with skepticism on Capitol Hill, and perhaps even the White House.⁶⁵ If the tariff reform is

57. *Permian Basin Area Rate Cases*, 390 U.S. at 780 (1968).

58. *FirstEnergy Servs. Co. v. FERC*, 758 F.3d 346, 353 (D.C. Cir. 2014) (citing *Boston Edison Co. v. FERC*, 233 F.3d 60, 64 (1st Cir. 2000); *Kan. Gas & Elec. Co. v. FERC*, 758 F.2d 713, 716 (D.C. Cir. 1985)).

59. *Atl. City Elec. v. FERC*, 295 F.3d 1, 9 (D.C. Cir. 2002) (citing *City of Campbell v. FERC*, 770 F.2d 1180, 1184-85 (D.C. Cir. 1985)).

60. *Wis. Pub. Power v. FERC*, 493 F.3d 239, 260 (D.C. Cir. 2007).

61. *City of Winnfield v. FERC*, 744 F.2d 871, 875 (D.C. Cir. 1984) ("§ 205, unlike § 206, allows the Commission to approve rate increases without a showing that current rates are unjust and unreasonable; it need only find the *proposed* rates to be just and reasonable.").

62. *Wis. Pub. Power*, 493 F.3d at 260 (D.C. Cir. 2007) (quoting *ExxonMobil Gas Mktg. Co v. FERC*, 297 F.3d 1071, 1084 (D.C. Cir. 2002)).

63. *FirstEnergy Serv. Co.*, 758 F.3d at 353 (D.C. Cir. 2014).

64. *Id.*; *Atl. City Elec.*, 295 F.3d at 10 (D.C. Cir. 2002) ("The courts have repeatedly held that FERC has no power to force public utilities to file particular rates unless it first finds the existing filed rates unlawful.").

65. See, *infra* note 69, (letters from the White House and U.S. Senators urging FERC to terminate a rule-making); *Order Terminating Proceeding, Remediating Undue Discrimination through Open Access Transmission Serv. and Standard Elec. Mkt. Design*, Docket No. RM01-12-000 (July 19, 2005) (terminating the Standard Market Design proceeding).

initiated under section 205, the Commission can defend its approval by pointing to the wishes of the market participants and states that generated the proposal. A move by FERC under section 206 would be factually more vulnerable to a political attack that it centralizes energy planning in Washington.⁶⁶ In addition, although courts do not distinguish between FERC's jurisdiction under sections 205 and 206, FERC's proactive assertion of jurisdiction under section 206 could be branded as overreach by the Commission and therefore be legally more vulnerable.⁶⁷

FERC's approval under section 205 would allow market participants to define FERC's role. New England is uniquely positioned to be a strong test case for FERC's legal authority and for state policymaking that would complement an RTO mechanism. Based on existing law and industry and economic trends, it is plausible that the region will continue to substantially reduce CO₂ emissions and increase renewable energy generation over the next few decades, regardless of FERC regulation or other federal policies.⁶⁸ States and market participants in other multi-state RTOs are not so similarly aligned. At the very least, ISO-NE's tariff ought not to impede achievement of state environmental and energy goals, and it is difficult to defend the position that FERC, in overseeing the ISO-NE tariff, is legally required to ignore these mandates or may only move to counteract their effects on FERC-jurisdictional rates.

Of course, government intervention in the electricity industry, whether as market participant, provider of incentives, or market regulator, has always been subject to political attack.⁶⁹ Even if FERC concludes that an RTO tariff that includes zero-emission energy or capacity procurement mechanisms or CO₂ prices

66. It is beyond the scope of this article to discuss whether factual distinctions matter in political debate. See generally HARRY G. FRANKFURT, ON BULLSHIT (2005).

67. The Supreme Court's warning in *Util. Air Regulatory Grp. v. EPA*, 134 S. Ct. 2427, 2444 (2014) about agency overreach provides challengers with one line of attack. There, the Court warned that:

[w]hen an agency claims to discover in a long-extant statute an unheralded power to regulate "a significant portion of the American economy," we typically greet its announcement with a measure of skepticism. We expect Congress to speak clearly if it wishes to assign to an agency decisions of vast "economic and political significance."

Id. (citations omitted). The potential repercussions of this language are hotly debated by legal scholars. See, e.g., Eilliam W. Buzbee, et al., *Climate Regulation Under the Clean Air Act in the Wake of Utility Air Regulatory Group v. EPA*, 39 HARV. ENVTL. L. REV. 1 (2015) (including eight articles about this decision).

68. See, e.g., BERKELEY NAT'L LAB., RPS DEMAND PROJECTIONS (last updated Sep. 2016), https://emp.lbl.gov/sites/all/files/RPS%20Demand%20Projections_Sept%202016.xlsx (showing that the total quantity of energy procured for RPS compliance is expected to double by 2036 as compared to the quantity procured in 2015); *Kain v. Dept. of Env'tl Prot.*, 49 N.E.3d 1124 (Mass. 2016) (holding that Massachusetts regulators are required by statute to establish regulations that will facilitate compliance with a statutory mandate to reduce greenhouse gas emissions 80% by 2050).

69. See, e.g., KARL BOYD BROOKS, PUBLIC POWER, PRIVATE DAMS: THE HELLS CANYON DAM CONTROVERSY 131 (2009) (summarizing industry critiques of federal government construction of dams and its role as a market participant); *Public Power Promotion Termed Path to Socialism*, CHICAGO DAILY TRIBUNE, June 6, 1951, at 6 (reporting same); REPUBLICAN NAT'L CONVENTION, 2016 REPUBLICAN PARTY PLATFORM, at 22 ("We firmly believe environmental problems are best solved by giving incentives for human ingenuity and the development of new technologies, not through top-down, command-and-control regulations that stifle economic growth and cost thousands of jobs."); John S. Smoot, *Subsidies, Climate Change, Electric Markets and the FERC*, 35 ENERGY L. J. 345, 346, 350 (2014) (criticizing government subsidies for "creating a toxic mix of imperfect competition and imperfect regulation" and for "distort[ing] resource allocation by diverting resources

is just and reasonable, FERC's order will be challenged in federal court on multiple grounds.

C. Integrating Markets and Public Policy is Just and Reasonable and Consistent with the FPA's Ultimate Purposes

In its decision upholding FERC jurisdiction to regulate compensation for demand response, the Supreme Court observed that FERC's "justifications for regulating demand response are all about, and only about, improving the wholesale market."⁷⁰ So too, FERC's justifications for approving a tariff that integrates markets and public policies should be "all about, and only about, improving the wholesale market." As discussed above, FERC's toolbox is not limited to a particular "formula" or by "textbook economic analysis." FERC may account for "practical realities" and include "pragmatic adjustments." The plasticity of the just and reasonable standard and the nature of FERC's review under section 205, combined with the "great deference" that courts afford FERC's technical and policy judgments, provide FERC with multiple pathways for approving a tariff proposal.

This section of the article provides the framework of a legal argument that supports FERC's authority to approve a tariff that integrates markets and public policy. Ultimately, the evidence in the record put forward by market participants and other parties must drive FERC's analysis and rationale. This section includes examples of factual conclusions and economic theory that would be legally relevant to FERC's determination, but it does not intend to identify any specific facts that are necessary for FERC's approval or to limit the types of evidence that may support FERC's determinations. This article aims to provide a legal foundation on which economic and other technical evidence must be added.

The Supreme Court has recognized in recent cases that "enhancing competition" is FERC's primary tool for ensuring that rates are just and reasonable.⁷¹

from higher valued to lower valued uses" and "produc[ing] a less efficient global division of labor, leading to lower economic welfare"); Alan O. Sykes, *The Economics of WTO Rules on Subsidies and Countervailing Measures* 6 (Chicago: John M. Olin Law & Econ. Working Paper No. 186, 2d Series, May 2003), http://chicago.bound.uchicago.edu/cgi/viewcontent.cgi?article=1515&context=law_and_economics; Order Terminating Proceeding, *Remedying Undue Discrimination through Open Access Transmission Serv. and Standard Elec. Mkt. Design*, Docket No. RM01-12-000 (containing 09/18/02 letter from Sen. McConnell enclosing a constituent's comment opposing the rulemaking, 09/24/02 letter from Sen. Bingaman that includes questions from six Senators directed to the Chairman about the rulemaking, 10/07/02 letter from Sen. Murray and four U.S. representatives urging FERC to abandon the Standard Market Design rulemaking, 11/05/02 correspondence from the White House requesting that FERC respond to an enclosed letter from a citizen in Idaho that urges FERC to abandon the rulemaking, 05/01/03 letter from ten Senators to Sen. Domenici, Chair of the Senate Committee on Energy and Natural Resources, urging him to limit FERC's authority to prevent it from finalizing the rulemaking and "federalizing" electricity regulation, 07/26/04 letter from 20 U.S. Senators "strongly urging" FERC to abandon the rulemaking, noting that "on numerous occasions . . . Congress has clearly communicated its concern with the Commission's attempts to 'mandate' participation in [RTOs]," and admonishing FERC for "demonstrat[ing] that neither comment nor action from Congress can deter it from this ill-advised path.").

70. *Elec. Power Supply Ass'n*, 136 S. Ct. at 776.

71. *Id.* (quoting *Morgan Stanley Capital Grp.*, 554 U.S. at 538); *Hughes v. Talen Energy Mktg., LLC*, 136 S.Ct. 1288, 1292 (2016) (citing *Elec. Power Supply Ass'n*, 136 U.S. at 766); *OneOK, Inc. v. Learjet*, 135 S. Ct. 1591, 1597 (2015) (recognizing that "FERC adopted an approach that relied on the competitive marketplace, rather than classical regulatory rate-setting, as the main mechanism for keeping *wholesale* natural-gas rates at a reasonable level").

Thus, if FERC can conclude that there is adequate support in the record that a tariff proposal will further that goal, it can approve the tariff as just and reasonable. For instance, FERC might determine that enabling the creation of regional markets for zero-emission energy or capacity in order to shift compliance with state renewable energy mandates from utility RFPs for long-term contracts to regional auction markets would enhance competition and balance consumer and investor interests. Based on these findings, FERC could conclude that the tariff will result in just and reasonable rates.

That conclusion would be legally sufficient to justify FERC's approval of the tariff. Indeed, FERC's determination, based on technical evidence that a tariff will result in just and reasonable rates is the crux of any RTO tariff approval. As discussed above, courts defer to FERC's just and reasonable determination, and challengers asking a court to overturn that conclusion would carry a "heavy burden."⁷² FERC's determination about a tariff that integrates markets and public policies would be entitled to the same level of deference.

However, unlike routine tariff approval orders, FERC's order approving a tariff that integrates markets and public policies is likely to be challenged on the grounds that it exceeds FERC's jurisdiction. The *EPSA* decision teaches that it would "subvert the FPA" to deny FERC jurisdiction over a practice that directly affects rates when the Commission's regulation of that practice is aimed at achieving the FPA's ultimate purposes.⁷³ FERC could therefore bolster the legal defensibility of its approval by demonstrating that wholesale-market-based compliance with public policy mandates is consistent with its statutory duties.

The Supreme Court has said that: (1) a "major purpose of the [FPA] is to protect power consumers against excessive prices;"⁷⁴ (2) a "principal purpose of [the FPA] was to encourage the orderly development of plentiful supplies of electricity . . . at reasonable prices;"⁷⁵ and (3) the FPA has "an overriding policy of maintaining competition to the maximum extent possible consistent with the public interest."⁷⁶ Assuming support in the record, FERC could connect the proposed

72. *Permian Basin Area Rate Cases*, 390 U.S. at 767 (quoting *Hope Nat. Gas Co.*, 320 U.S. at 602).

73. *Elec. Power Supply Ass'n*, 136 S. Ct. at 780–82.

The statute aims to protect 'against excessive prices' and ensure effective transmission of electric power. As shown above, FERC has amply explained how wholesale demand response helps to achieve those ends, . . . We will not read the FPA, against its clear terms, to halt a practice that so evidently enables the Commission to fulfill its statutory duties of holding down prices and enhancing reliability in the wholesale energy market.

Id. (citations omitted); *Permian Basin Area Rate Cases*, 390 U.S. at 780 (1968) (FERC "[a]dministrative action imperative for achievement of [its] ultimate purpose" will not be prohibited by a court "in the absence of compelling evidence that such was Congress' intention.").

74. *Pa. Water & Power Co.*, 343 U.S. at 418; *Elec. Power Supply Ass'n*, 136 S. Ct. at 781.

75. *Nat'l Ass'n for Advancement of Colored People*, 425 U.S. at 671.

76. *Otter Tail Power Co. v. U.S.*, 410 U.S. 366, 374 (1973); *Gulf States Utils. Co. v. FPC*, 411 U.S. 747, 758 (1973).

The Act had two primary and related purposes: to curb abusive practices of public utility companies by bringing them under effective control, and to provide effective federal regulation of the expanding business of transmitting and selling electric power in interstate commerce. . . . This power clearly

tariff to these core duties. As examples, evidence demonstrating that a tariff proposal will: (1) benefit consumers by harmonizing fragmented implementation of state renewable energy or CO₂ mandates; or (2) encourage development of resources that diversify supply and meet market participants' legal requirements; or (3) further competition in wholesale electric markets, would all align FERC's approval with its core duties. Once FERC has determined that the tariff will result in just and reasonable rates, a court will be reluctant to cut off FERC's jurisdiction and "halt a practice that so evidently enables [FERC] to fulfill its statutory duties,"⁷⁷ unless the court concludes that the FPA unambiguously prohibits FERC's approval.⁷⁸

FPA section 202 provides further support for FERC's authority to approve an RTO tariff that facilitates achievement of public policies.⁷⁹ Nearly forty years ago, FERC explained that "[t]he importance of encouraging coordinated planning and operation of bulk power supply systems has been a cornerstone of Commission policy for many years."⁸⁰ Section 202(a) supported FERC's guidance on RTOs (FERC Order No. 2000) and FERC's landmark rule about regional transmission planning (FERC Order No. 1000). Assuming support in the record, FERC's approval of an RTO proposal that harmonizes compliance with public policies would be consistent with its "duty" under section 202(a) to "promote and encourage . . . coordination" "[f]or the purpose of assuring an abundant supply of electric energy . . . with regard to . . . conservation of natural resources."⁸¹

In addition, the D.C. Circuit has said that "one might reason that [section 202(a) and the section 201 public interest mandate] empower [FERC] to consider overall fuel-supply economics and the social consequences of energy shortages, but that it need not invariably do so if the rates are just and reasonable in the traditional regulatory sense."⁸² The issue in that case was whether wholesale electric rates designed to address the 1973 oil embargo were necessarily unreasonable if they did not lead to a reduction in the use of imported oil.⁸³ The court concluded

carries with it the responsibility to consider, in appropriate circumstances, the anticompetitive effects of regulated aspects of interstate utility operations. *Id.*

77. *Elec. Power Supply Ass'n*, 136 S. Ct. at 782.

78. *Id.*; *Permian Basin Area Rate Cases*, 390 U.S. at 780 (1968) (FERC "[a]dministrative action imperative for achievement of [its] ultimate purpose" will not be prohibited by a court "in the absence of compelling evidence that such was intention of Congress.").

79. 16 U.S.C. § 824a(a) states:

For 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, the Commission is empowered and directed to divide the country into regional districts for the voluntary interconnection and coordination of facilities for the generation, transmission, and sale of electric energy. . . . It shall be the duty of the Commission to promote and encourage such interconnection and coordination within each such district and between such districts. *Id.*

80. *Pub. Serv. Co. of Ind. Inc.*, 59 FPC 1351, 1355 (1977).

81. 16 U.S.C. § 824a(a). FERC has rarely, if ever, invoked this aspect of § 202(a). In 1973, the FPC issued Order No. 496, which was designed to achieve, among other goals, "all possible savings by electric utilities in their consumption of petroleum and natural gas for the generation of electric power." The order cites to § 202, and is consistent with the FPA's charge to consider conservation.

82. *Richmond Power & Light*, 574 F.2d at 616 n. 22.

83. *Id.* at 613.

that FERC “may rationally decline to affirmatively foster other policies [such as energy independence] in weighing the specific interests that it is required by statute to consider.”⁸⁴

FERC may not be *required* under the FPA to proactively consider environmental or renewable energy policies.⁸⁵ In approving a tariff filed under section 205, FERC would not have to justify a decision to “affirmatively foster” environmental goals because it would be deferring to the tariff filer’s decision to account for “the social consequences of energy” supply insofar as they affect jurisdictional rates. The “specific interests that [FERC] is required by statute to consider” are those of the consumer and investor.⁸⁶ FERC’s “essentially passive and reactive”⁸⁷ role under section 205 allows it to defer to the RTO’s proposed balancing of those interests, provided FERC can conclude that it will result in just and reasonable rates and is consistent with FERC’s statutory duties.

In summary, once FERC establishes that a proposed tariff will result in just and reasonable wholesale rates it has legal authority to approve the tariff under section 205. Assuming support in the record, FERC could conclude that a tariff that facilitates compliance with public policy goals is just and reasonable because it “break[s] down regulatory and economic barriers that hinder a free market in wholesale electricity.”⁸⁸ FERC can defend its legal authority to approve the tariff by showing that its approval is consistent with its regulatory mission under the FPA and with its duty under section 202(a) to promote and encourage industry coordination. A reviewing court will defer to FERC’s just and reasonable determination and should uphold FERC’s approval unless it concludes that it is unambiguously prohibited by the FPA. Whether FPA section 201 bars FERC’s approval is addressed in the next section.

II. CASE STUDY: NEPOOL’S INTEGRATING MARKETS AND PUBLIC POLICY PROCESS

The New England Power Pool’s (NEPOOL) Integrating Markets and Public Policy (IMAPP) stakeholder process aims to propose changes to the ISO-New England (ISO-NE) wholesale markets that are intended to advance state public policy objectives.⁸⁹ A “problem statement” released in May 2016 by the New England States Committee on Electricity (NESCOE), which represents the New England Governors, summarizes the issue:

Competitive wholesale electricity markets are designed to meet New England’s need to maintain reliability by selecting the lowest-cost resources. They do not include states’ legal obligation to execute state energy and environmental laws. However, as the markets move the region to increasing reliance on one fuel source for power generation, questions about reliability become more acute. The challenge is finding a

84. *Id.* at 617.

85. *Id.* at 616 n. 22 (stating that “[n]othing in *NAACP v. FPC* [] forecloses agency discretion to consider in given situations pervasive public policies that it is not required to evaluate in every decision it makes.”).

86. *Id.* at 617; *Hope Nat. Gas Co.*, 320 U.S. at 603.

87. *Atl. City Elec.*, 295 F.3d at 9.

88. *Elec. Power Supply Ass’n*, 136 S. Ct. at 768 (quoting *Morgan Stanley Capital Grp.*, 554 U.S. at 538).

89. See generally, NEPOOL, *Integrating Markets and Public Policy*, <http://nepool.com/IMAPP.php> (last accessed Feb. 22, 2017).

means to execute states' policy-related requirements at the lowest reasonable cost without unduly diminishing the benefits of competitive organized markets or amplifying the cost to consumers of implementing those state policies in order to maintain markets.⁹⁰

Three proposals have emerged from the stakeholder process:

- Include a carbon price in ISO-NE energy markets. Initial proposals outlined in summer 2016 aligned the carbon adder with the social cost of carbon.⁹¹ By late 2016, carbon-price proponents reduced their proposed initial prices below the federal government's measure of CO₂'s environmental harm.⁹²
- Modify the capacity market construct either: a) to protect the market from state mandates and subsidies; or b) to include a mechanism for procuring zero-emission resources. Under the former type of proposal, the capacity market would clear twice; the first time for total quantity of megawatts and the second time for price, with designated state-supported resources removed from that calculation.⁹³ Under the latter type of proposal, the capacity market would clear once, co-optimizing for the total quantity of megawatts needed for system adequacy and megawatt-hours of zero-emission credits demanded by utilities.⁹⁴
- Create a Forward Clean Energy Market (FCEM) that allows utilities to procure long-term commitments (one to ten years) for renewable energy credits (RECs) or energy, and RECs from zero-emission generators.⁹⁵

These three IMAPP proposals raise legal questions about the FPA that have not been answered definitively by FERC or the courts. This section provides preliminary assessments of the proposals' legal vulnerabilities. It begins with three threshold objections that opponents are likely to raise, relevant to any of the IMAPP proposals under consideration. It then examines questions specific to each of the three types of proposals.

90. NESCOE, POLICIES AND MARKETS PROBLEM STATEMENT 1 (May 17, 2016), http://www.nepool.com/uploads/IMAP_20160517_Problem_Statement.pdf.

91. Robert Stoddard & Jerry Elmer, Conservation Law Foundation, Presentation: A Competitive Markets Design to Achieve New England's Energy Decarbonization Goals 7-8 (Sept. 14, 2016), http://nepool.com/uploads/IMAPP_20160914_Presentation_FCM-C.pdf; Exelon, Presentation: Using Carbon Price to Cost-effectively Meet Clean Generation Goals in New England (Aug. 11, 2016), http://nepool.com/uploads/IMAPP_Presentation_exelon.pdf.

92. Robert Stoddard, et al., Conservation Law Foundation, Presentation: CLF Proposal Potential Adjustments 7-8 (Nov. 10, 2016), http://nepool.com/uploads/IMAPP_20161110_CLF_FCM-C_Potential_Adjustments.pdf; Exelon, Presentation: Update on Carbon Price Proposal (Nov. 10, 2016), http://nepool.com/uploads/IMAPP_20161110_Exelon_Carbon_Price_Proposal_Update.pdf.

93. NEPOOL, FRAMEWORK DOCUMENT — TWO-TIER FCM PRICING 2 (Sept. 12, 2016), http://nepool.com/uploads/IMAPP_20160914_Framework_NRG_rev.pdf.

94. Stoddard & Elmer, *supra* note 91, at 13.

95. NEPOOL, FORWARD CLEAN ENERGY MARKET (FCEM) FRAMEWORK DOCUMENT 1 (Sep. 12, 2016), http://nepool.com/uploads/IMAPP_20160914_Framework_FCEM.pdf.

A. Are IMAPP Proposals Unambiguously Prohibited by FPA Section 201 Because They Regulate Generation Facilities?

Under FPA section 201, “states regulate [generation] facilities, while FERC regulates sale and transmission.”⁹⁶ IMAPP opponents may argue that a FERC-jurisdictional tariff may not include mechanisms that facilitate procurement of specific types of resources, or that account for emissions, because these mechanisms would impermissibly regulate generation facilities. The key question is whether FERC approval of an IMAPP proposal oversteps FERC’s jurisdiction under section 201. Under *Detroit Edison*, that would be fatal to FERC’s approval.

Opponents of FERC-regulated capacity markets have repeatedly argued that FERC’s regulation of capacity procurement mechanisms transgresses the Commission’s jurisdictional limits. Federal appeals courts have rejected those arguments in each case.⁹⁷ The first example was in 1978; FERC approved a NEPOOL agreement that penalized utilities for failing to hold sufficient capacity.⁹⁸ The D.C. Circuit concluded that although the charge may “motivate [utilities] to develop sufficient [generation] capacity,” FPA section 201 did not prevent FERC from approving the agreement.⁹⁹ The court concluded that FERC had jurisdiction because the agreement’s disputed provision “affects the fee that a participant pays for [FERC-jurisdictional] power and reserve service.”¹⁰⁰

Twenty-one years later, the D.C. Circuit similarly held that FERC may regulate ISO-NE’s installed capacity requirement (ICR), a key input into the capacity market that represents the estimated amount of capacity the system requires for reliability.¹⁰¹ The D.C. Circuit panel concluded that FERC’s review of the ICR was not “direct regulation” of generation facilities in violation of section 201, reasoning that “[d]etermination of the ICR affects rates within the Commission’s jurisdiction and, in evaluating whether that determination is just and reasonable, the Commission neither regulates generation facilities in violation of section 201 nor runs afoul of any other provision of the Federal Power Act.”¹⁰²

In 2014, the D.C. Circuit again upheld FERC’s regulation of the ISO-NE capacity market.¹⁰³ At issue was a rule intended to mitigate buyer-side market

96. *New England Power Generators Ass’n v. FERC*, 757 F.3d 283, 290 (D.C. Cir. 2014).

97. *N.J. Bd. of Pub. Utils. v. FERC*, 744 F.3d 74, 95–98 (3rd Cir. 2014) (rejecting argument that changes to PJM’s Minimum Offer Price Rule “amount[s] to direct regulation of generating facilities”); *New England Electric Power Generators Ass’n*, 757 F.3d at 290 (upholding buyer side mitigation measures despite arguments that they “serve to dictate which resources a utility must use to satisfy its capacity obligations” and “impermissibly determine the makeup of a state’s resource portfolio.”); *Conn. Dep’t of Pub. Util. Control v. FERC*, 569 F.3d 477, 481–83 (D.C. Cir. 2009) (holding that FERC may regulate Installed Capacity Requirement as it affects FERC jurisdictional rates, even if the requirement could result in the construction of facilities, a matter under state jurisdiction); *Municipalities of Groton v. FERC*, 587 F.2d 1296, 1300–03 (D.C. Cir. 1978) (concluding that FERC approval of a capacity deficiency charge does not encroach on state jurisdiction, even though it may “motivate [utilities] to develop sufficient capacity to meet their load requirements”).

98. *New England Power Pool Agreement*, Docket No. 76-2087 (Nov. 4, 1978).

99. *Municipalities of Groton*, 587 F.2d at 1302.

100. *Id.* (emphasis added).

101. *Conn. Dep’t of Pub. Util. Control*, 569 F.3d at 478-79.

102. *Id.* at 475, 485 (emphasis added).

103. *New England Power Generators Ass’n*, 757 F.3d at 285.

power. The court “stress[ed] that FERC’s mitigation measures here do not entail direct regulation of facilities” and rejected arguments to the contrary.¹⁰⁴ Rather, “states remain free to subsidize the construction of new generators, and load serving entities to build or contract for any self-supply they believe is necessary; FERC’s orders simply regulate” wholesale rates.¹⁰⁵

Also in 2014, the Third Circuit upheld FERC’s approval of PJM’s capacity market construct.¹⁰⁶ The challenged order allowed PJM to remove tariff provisions that explicitly accounted and allowed for generation resources subsidized through New Jersey and Maryland laws. The two states protested, claiming that the tariff provisions were necessary for development of resources that meet the states’ reliability needs and furthered their environmental and economic goals.¹⁰⁷ The Third Circuit upheld FERC’s order, in part because it found that the states “were actually structuring contracts for the development of new resources in a way that would substantially suppress [PJM] prices.”¹⁰⁸ The court added that “what FERC has actually done here is permit states to develop whatever capacity resources they wish, and to use those resources to any extent that they wish, while approving rules that prevent the state’s choices from adversely affecting wholesale capacity rates. Such action falls squarely within FERC’s jurisdiction.”¹⁰⁹

Although this line of cases is about capacity markets, it can be read more broadly. The cases draw a distinction between a state’s direct regulation of generation facilities and FERC’s direct regulation of wholesale sales from those facilities. As the industry has shifted to increasingly rely on FERC-regulated wholesale sales, the jurisdictional lines between state and federal authority have blurred. Generation procurement is an area of shared authority; states retain jurisdiction over siting, environmental standards, and fuel choices, while FERC has jurisdiction over matters that directly affect wholesale rates. There may not be a “bright line” demarcating where FERC jurisdiction ends and state authority begins,¹¹⁰ as

104. *Id.* at 290.

105. *Id.* at 291.

106. *N.J. Bd. of Pub. Utils.*, 744 F.3d at 79.

107. *Id.* at 99.

108. *Id.* at 102.

109. *Id.* at 98.

110. The Supreme Court has not explicitly overturned the “bright line” jurisdictional test that it articulated in *FPC v. Southern California Edison, Co.*, 376 U.S. 199 (1964). Yet, it is noteworthy that the Court’s three recent decisions about the jurisdictional divide between FERC and the states do not cite the bright line test. To the contrary, the court questions its relevance to modern energy markets. *OneOK, Inc.*, 135 S.Ct. at 1601 (“Petitioners and the dissent argue that there is, or should be, a clear division between areas of state and federal authority in natural-gas regulation. But that Platonic ideal does not describe the natural gas regulatory world.”). Both *EPSA* and Justice Sotomayor’s concurrence in *Hughes* describe the relationship between federal and state authority as consistent with concurrent (shared) rather than plenary (bright line) jurisdiction. See Jim Rossi, *The Brave New Path of Energy Federalism*, 95 TEX. L. REV. 399 (2016). In dissent, Justice Scalia twice attempts to reinforce the bright line rule (*OneOK, Inc.*, 135 S. Ct. at 1607; *Elec. Power Supply Ass’n*, 136 S. Ct. at 786), but each opinion is joined by only one other Justice. *Hughes* presented facts that were tailor-made for reasserting the relevance of the bright line, but the Court’s unanimous opinion does not mention it. Appeals courts may decide that these cases overturn the bright line test by implication. In an “implied overruling” the Supreme Court “determines that the rule of law that the precedent enunciated is no longer correct” without stating that it is overturning precedent. Margaret N. Kniffen, *Overruling Supreme Court Precedents: Anticipatory Actions by*

the Supreme Court concluded fifty years ago.¹¹¹ Today, states' choices about wind, gas, or other fuels certainly affect wholesale rates. The increased role of FERC-regulated spot markets, unanticipated by Congress in 1935, ought not diminish a state's ability to exercise its historic authority over generation facilities.

FERC approval of an IMAPP proposal would be consistent with recent Supreme Court decisions that recognize a federal-state relationship that is "complementary"¹¹² and "marked by interdependence"¹¹³ as well as more expansive FERC authority, exemplified by *EPSA*.¹¹⁴ As Jim Rossi argues, these cases acknowledge that FERC and states may "coordinate regulatory approaches or operate adjacent programs that touch on the same regulatory topics."¹¹⁵

In one of its first decisions about the FPA, the Supreme Court quoted with approval a House Committee report on the bill declaring that the FPA was written so "as to be a complement to and in no sense a usurpation of State regulatory authority."¹¹⁶ IMAPP proposals ought to be designed to "complement" state programs by "provid[ing] a carrot that states won't be able to resist eating."¹¹⁷ Complementary programs would allow states to continue to make decisions about particular resources and would not preempt states' choices, so long as state policies do not directly regulate the wholesale rate.¹¹⁸ States should be permitted, if they so choose, to continue to design procurement mechanisms that are independent of the RTO market. A well-designed RTO mechanism would induce states (through their regulated utilities) to participate, rather than mandate participation.

B. May FERC Approve Tariff Provisions That Are Premised in Part on Public Policy?

At the outset, it is worth highlighting that FERC must always determine whether or not an RTO tariff filing will result in just and reasonable and not unduly discriminatory rates. That market participants incur costs due to energy and environmental policies that are incorporated into RTO tariffs does not excuse FERC from assessing whether cost recovery mechanisms result in just and reasonable rates. FERC may not approve a tariff solely because it is premised on public policy. That said, FERC's determination that rates will be just and reasonable under

United States Courts of Appeals, 51 *FORDHAM L. REV.* 53, 57 (1982); *see also* Bradley Scott Shannon, *Overruled by Implication*, 33 *SEATTLE U. L. REV.* 151 (2009).

111. *S. Cal. Edison Co.*, 376 U.S. at 215 ("Congress meant to draw a bright line, easily ascertained, between state and federal jurisdiction.")

112. *Elec. Power Supply Ass'n*, 136 S. Ct. at 780 (quoting *FPC v. La. Power & Light Co.*, 406 U.S. 621, 631 (1972)).

113. *Hughes*, 136 S. Ct. at 1300 (J. Sotomayor, concurring); *see also OneOK, Inc.*, 135 S. Ct. at 1601 ("Petitioners and the dissent argue that there is, or should be, a clear division between areas of state and federal authority in natural-gas regulation. But that Platonic ideal does not describe the natural gas regulatory world.")

114. *See* Joel Eisen, *FERC's Expansive Authority to Transform the Electric Grid*, 49 *U.C. DAVIS L. REV.* 1783 (2016).

115. Rossi, *supra* note 110, at 452.

116. *Conn. Light & Power Co. v. FPC*, 324 U.S. 515, 525 (1945) (quoting Hearings on H.R. 5423 Before H. Comm. on Interstate and Foreign Commerce, 74th Cong. 384 (1935)).

117. *Ill. Commerce Comm'n. v. FERC*, 721 F.3d 764, 773 (7th Cir. 2013).

118. *See infra*, § III.A.

an IMAPP mechanism is likely to be premised in part on its recognition that market participants incur costs in order to meet obligations under state and federal law. IMAPP opponents may raise a threshold jurisdictional objection, arguing that FERC is prohibited from approving an RTO market mechanism that facilitates compliance with policies that FERC does not administer.

A recent order establishes FERC's understanding that accommodating state policies is a legitimate objective of an RTO market tariff. In rejecting a NESCOE complaint that requested that FERC require an exemption for state-mandated renewable resources from capacity market bidding rules, FERC stated that it "must balance two considerations. The first is its responsibility to promote economically efficient markets and efficient prices, and the second is its interest in accommodating the ability of states to pursue other legitimate state policy objectives."¹¹⁹

Two examples, one from the Midcontinent ISO (MISO) and another from ISO-NE, illustrate that FERC has approved RTO tariffs that are premised in part on state policies. In 2010, the MISO and its member transmission-owning utilities submitted transmission tariff amendments that allocated costs among market participants of so-called Multi-Value Projects (MVP).¹²⁰ The section 205 tariff filing explained that MVPs "enable the reliable and economic delivery of energy in support of *documented energy policy mandates*."¹²¹ FERC approved the tariff filing, noting that the tariff "allows [M]ISO and stakeholders to identify transmission projects that will have positive benefits for the grid, and that may also *satisfy legal and public policy goals* in addition to providing just and reasonable pricing on a non-discriminatory basis."¹²² The Seventh Circuit subsequently upheld FERC's approval, observing that the tariff is "mainly intended to finance the construction of transmission lines for electricity generated by remote wind farms. Every state in MISO's region except Kentucky (which is barely in the region) encourages or even requires utilities to obtain a specified percentage of their electricity supply from renewable sources, mainly wind farms."¹²³

FERC has also recognized state renewable policies in its approval of capacity market rules. In 2014, ISO-NE and NEPOOL submitted revisions to capacity market rules that included an exemption from buyer-side market power mitigation rules for certain renewable energy resources that qualify under any New England state's renewable portfolio standard.¹²⁴ The exemption was designed to "permit[] market participants to satisfy their renewable portfolio standard obligations without imposing additional costs on consumers."¹²⁵ In approving the exemption under section 205, FERC stated that the exemption "recognizes all New England

119. *New England States Comm. on Elec.* 142 F.E.R.C. ¶ 61,108 at P 35 (2013).

120. *Midcontinent Indep. Sys. Operator, Inc.*, 156 F.E.R.C. ¶ 61,235 at P 2 (2016).

121. Midwest ISO Filing, Docket No. ER10-1791, Part 1 of 3, at 2 (Jul. 15, 2010) (emphasis added).

122. *Midwest Indep. Transmission Sys. Operator, Inc.*, 133 F.E.R.C. ¶ 61,221 at P 194 (2010) (emphasis added).

123. *Ill. Commerce Comm'n.*, 721 F.3d at 771.

124. *ISO New England & New England Power Pool Participants Comm.*, 147 F.E.R.C. ¶ 61,173 at P 1 (2014), *reh'g denied*, 150 F.E.R.C. ¶ 61,065 (2015).

125. *Id.* at P 64.

state policies, rather than favoring a particular approach,” and “is limited to complementing state programs promoting renewable resources.”¹²⁶

FERC’s landmark Order 1000 requires transmission owners to develop regional plans that consider transmission needs driven by public policy, including states’ renewable mandates.¹²⁷ FERC explained that the requirement to consider public policy in transmission tariffs is necessary because such policies “can directly affect the need for interstate transmission facilities, which are squarely within the Commission’s jurisdiction.”¹²⁸ FERC cautioned that its directive “cannot be construed as pursuing broad general welfare goals that extend beyond matters subject to our authority under the FPA.”¹²⁹ In upholding FERC’s order, which was promulgated under FPA section 206, the D.C. Circuit cabined FERC’s authority, writing that the order merely establishes a planning process that requires jurisdictional utilities to consider relevant public policies.¹³⁰ According to the court, utilities, and not FERC, will identify the “state and federal policies [that] might affect the transmission market.”¹³¹

These examples highlight that FERC has both approved tariffs that are premised on specific state renewable policies, and mandated that utilities consider state and federal policies that directly affect a FERC-jurisdictional market. However, both *Illinois Commerce Comm’n* and *S.C. Pub Serv. Authority* are about FERC’s authority over transmission, and there is not yet a court decision affirming similar FERC authority over RTO market rules. The D.C. Circuit has stated that FERC “possesses greater authority over electricity transmission than it does over sales . . . [and] the FPA preserves for the States relatively more sales authority than transmission authority.”¹³² It is certainly possible for a court to read this statement as a limiting principle that would implicate FERC authority over IMAPP. Perhaps, a court might conclude, FERC may only support the delivery of energy mandated by state policy but may not directly advance those state policies. However, a more straightforward reading of this limit is the uncontroversial holding in *New York v. FERC* that FERC may not regulate retail sales while it may assert jurisdiction over retail transmission.¹³³ This limitation on FERC’s jurisdiction should not prevent FERC from incorporating state renewable energy and CO₂ policies into RTO market rules.

FERC-regulated RTO markets have thus far limited their responses to state policies with rules intended to prevent price suppression due to out-of-market payments to state-supported resources. Such market rules are implicitly premised on the conclusion that utility practices in response to state policies directly affect rates. As a practical matter, as the magnitude of the policies and utility responses

126. *Id.* at P 82.

127. Order No. 1000, *Transmission Planning and Cost Allocation by Transmission Owning and Operating Pub. Util.*, 136 F.E.R.C. ¶ 61,051 at P 67 (2011).

128. *Id.* at P 111.

129. *Id.*

130. *S.C. Pub. Serv. Auth. v. FERC*, 762 F.3d 41, 91 (D.C. Cir. 2014).

131. *Id.* at 89.

132. *Id.* at 62 (citing *New York v. FERC*, 535 U.S. 1, 17 (2002)).

133. *New York v. FERC*, 535 U.S. 1 (2002).

grows, FERC ought to be able to respond accordingly.¹³⁴ Jim Rossi argues that “recognition of concurrent [or shared] jurisdiction opens up new institutional arrangements where state and federal regulators can coordinate regulatory approaches or operate adjacent programs that touch on the same regulatory topics.”¹³⁵ The FPA does not suggest that in fulfilling its duty to maintain just and reasonable rates FERC may only deploy limited responses to state policies. Rather, Rossi concludes that “these are pragmatic choices about the best institutional balance for regulating modern energy markets— decisions that Congress has delegated to FERC in recognition of its expertise.”¹³⁶

A more general objection to FERC’s authority to incorporate public policy is that IMAPP proposals do not merely accommodate policies, as the examples illustrate, but more intrusively effectuate them in FERC-regulated markets.¹³⁷ A key limit that FERC placed on itself was that it did not “favor” any particular policy or resource, and merely allowed or required utilities to implement or account for state policies in a FERC-jurisdictional tariff at their discretion. Assuming that ISO-NE identifies relevant policies or resources in its section 205 IMAPP filing, FERC’s approval would be consistent with this precedent. As discussed in section III.C, the role that states may then play in implementing a FERC-jurisdictional tariff is a subject of ongoing controversy.

A final objection to incorporating state renewable energy policies is that such laws are typically aimed at utilities, which are purchasers in the ISO-NE market. “The entire thrust of Part II [of the FPA] is toward the seller at wholesale, not the buyer.”¹³⁸ FERC has not made this distinction with regard to state policies. In Order No. 1000, FERC did not limit the public policy mandate to policies that placed legal obligations on transmission providers. The order allows, and may even require, consideration of policies relevant to transmission *customers*, such as

134. State renewable portfolio standards typically require electricity distributors to procure an annually escalating amount of energy from renewable generators. The Lawrence Berkeley National Lab calculates that in 2010 entities with compliance obligations procured 146 TWh of renewable energy or RECs. In 2020, those entities are expected to procure 314 TWh. LAWRENCE BERKELEY NAT’L LAB., RPS COMPLIANCE DATA, https://emp.lbl.gov/sites/all/files/RPS%20Compliance%20Data_Feb%202016.xlsx (last updated Feb. 2016); LAWRENCE BERKELEY NAT’L LAB., RPS DEMAND PROJECTIONS, https://emp.lbl.gov/sites/all/files/RPS%20Demand%20Projections_Sept%202016.xlsx (last updated Sep. 2016).

135. Rossi, *supra* note 110, at 452; *see also Elec. Power Supply Ass’n*, 136 S. Ct. at 780 (quoting *La. Power & Light Co.*, 406 U.S. at 631) (The FPA “makes federal and state powers ‘complementary’”); *Hughes*, 136 S. Ct. at 1300 (J. Sotomayor, concurring) (the FPA, “like all collaborative federalism statutes, envisions a federal-state relationship marked by interdependence”).

136. Rossi, *supra* note 110, at 454.

137. *See, e.g.,* Pete Fuller, NEPOOL IMAPP Stakeholder Discussion, Capacity Markets & Efficient Renewable Procurement in a Carbon-Constrained World: Near-term vs. Long-term 2 (Oct. 21, 2016), http://nepool.com/uploads/IMAPP_20161021_NRG.pdf (differentiating between IMAPP proposals that “accommodate” and those that “achieve” state policy objectives); DONALD J. SIPE, FOUR POSSIBLE FUNCTIONALITIES OF IMAPP REFORMS 2, http://nepool.com/uploads/IMAPP_20161006_Position_Sipe_Functionalities.pdf (last accessed Feb. 28, 2017) (distinguishing between IMAPP proposals that “advance” state policies and those that are “purely defensive reforms designed to protect price formation.”).

138. *Cal. Elec. Power Co. v. FPC*, 199 F.2d 206, 209 (9th Cir. 1952).

utilities.¹³⁹ The D.C. Circuit explained that the public policy “mandate simply recognizes that state and federal policies might affect the *transmission market*.”¹⁴⁰

C. Do IMAPP Proposals Unduly Discriminate Against Emitting Resources?

Claims of “undue preference” or “undue discrimination” are easy to allege but difficult to prove.¹⁴¹ In recent capacity market reform proceedings before FERC, participants casually claim undue discrimination when proposed market rules disadvantage their preferred resources. These assertions are often unsupported by FERC precedent, let alone federal court decisions. Opponents of IMAPP proposals will surely allege that they are discriminatory, while proponents will argue that any discrimination is justifiable and therefore not “undue.” Neither side will have a strong legal foundation for its claims.

The prohibition against unduly discriminatory rates is historically rooted in concerns about a utility’s anticompetitive practices, such as reduced rates to its preferred customers.¹⁴² Traditionally, rates were considered unduly discriminatory if they did not reflect the costs of serving those ratepayers.¹⁴³ The inquiry has historically been customer-specific; a utility is prohibited from charging a price to one ratepayer and a materially different price for the same service to a different ratepayer.

The D.C. Circuit explained in 1984 in a case about cost-of-service regulation that

[i]f a rate design has different effects on charges for similar services to similar customers, the utility bears the burden of justifying these different effects. It can satisfy this burden by “offering a valid reason for the disparity or by demonstrating that the gap is as small as practicable under the circumstances.” Not all discrimination is necessarily unlawful. Section 205(b) proscribes any “unreasonable difference in rates” and any “undue preference or advantage.”¹⁴⁴

In that case, the court concluded that the rate design under review resulted in unlawful cross subsidization.¹⁴⁵ Neither the utility nor FERC (which had approved the rate) provided any “legally sufficient reason for charging [some] customers a rate that does not accurately reflect the cost of serving them” or “any evidence showing factual differences to justify the [rate] or to show that it is *de minimis*.”¹⁴⁶

139. 136 F.E.R.C. ¶ 61,051 at P 209.

140. *S.C. Pub. Serv. Auth.*, 762 F.3d at 89 (emphasis added).

141. Few court decisions differentiate between § 205’s undue preference standard and § 206’s undue discrimination standard. This article treats them equivalently. One exception is *Pub. Serv. Co. of Indiana v. FERC*, which states that “[t]he purpose behind section 205(b) is the protection of the consumer’s interest, and the purpose behind section 206 is the protection of the public interest.” 575 F.2d 1204, 1213 (7th Cir. 1978).

142. See, e.g., Eisen, *supra* note 114, at 1799-1802 (tracing the prohibition against undue discrimination to turn-of-the-century railroad regulation and summarizing that early cases understood discrimination to refer to unlawful practices or advantages).

143. ALFRED E. KAHN, *THE ECONOMICS OF REGULATION: PRINCIPLES AND INSTITUTIONS: ECONOMIC PRINCIPLES* 63 (1970) (“The rule that individual rates not be unduly discriminatory similarly has been defined in terms of the respective costs of the various services.”).

144. *Elec. Consumers Res. Council v. FERC*, 747 F.2d 1511, 1515 (D.C. Cir. 1984) (citing *Ala. Elec. Co-op., Inc. v. FERC*, 684 F.2d 20, 27 (D.C. Cir. 1982)).

145. *Id.* at 1518.

146. *Id.* at 1516.

Courts accept disparate treatment between ratepayers “only if FERC offers a valid reason for the disparity.”¹⁴⁷

In the mid-1990s, FERC broadened the scope of its undue discrimination analysis to industry-wide anticompetitive practices. FERC explained that due to changing conditions in the electric utility industry, *e.g.*, the emergence of non-traditional suppliers and greater competition in bulk power markets, the focal point of claims of undue discrimination has changed from discrimination in the treatment of different customers to discrimination in the rates and services the utility offers third parties when compared to its own use of the transmission system.¹⁴⁸

Reviewing FERC’s open-access order, the D.C. Circuit concluded that the FPA’s “ambiguous antidiscrimination provisions . . . giv[e] [FERC] broad authority to remedy unduly discriminatory behavior.”¹⁴⁹ Many reforms instituted by FERC since that open-access order are aimed at remedying undue discrimination, including practices that discriminated specifically against renewable energy generators.¹⁵⁰

Recent undue discrimination claims about RTO tariffs are about cost allocation.¹⁵¹ In these cases, petitioners allege that the tariff allocates costs to or distributes surpluses among market participants in an unduly discriminatory fashion that fails to reflect the cost causation principle. In one recent case, the court’s review consisted of recounting FERC’s highly technical explanations for the approved methodology and then concluding that the “petitioners fail to show that the Commission did not examine the relevant data or articulate a rational connection between the facts found and the choice made, bearing in mind that the court’s review is highly deferential.”¹⁵² In that case, the court found no legal basis for overturning FERC’s technical and policy judgments.¹⁵³

IMAPP opponents might argue that a proposed market mechanism unduly discriminates based on environmental attributes or generation technology.¹⁵⁴ FERC has addressed similar arguments in its approval of PJM capacity market

147. *Black Oak Energy, LLC v. FERC*, 725 F.3d 230, 240 (D.C. Cir. 2013) (quoting Elec. Consumers Res. Council, 747 F.2d at 1515); *see also* *Ark. Elec. Energy Consumers v. FERC*, 290 F.3d 362, 367 (D.C. Cir. 2002) (“A rate is not unduly preferential or unreasonably discriminatory if the utility can justify the disparate effect.”).

148. *Am. Elec. Power Serv. Corp.*, 67 F.E.R.C. ¶ 61,168, at 61,490 (1994) (citing *New England Power Pool*, 67 F.E.R.C. ¶ 61,042 (1994)).

149. *Transmission Policy Access Grp.*, 225 F.3d at 684; *see also* 75 F.E.R.C. ¶ 61,080 at P 50 (“Non-discriminatory open access to transmission services is critical to the full development of competitive wholesale generation markets and the lower consumer prices achievable through such competition.”).

150. *See, e.g.*, Order No. 764, *Integration of Variable Energy Resources*, 139 F.E.R.C. ¶ 61,246 at PP 6–9 (2012); Order No. 792, *Small Generator Interconnection Agreements & Procedures*, 145 F.E.R.C. ¶ 61,159 at PP 15, 21–23 (2013).

151. *See, e.g.*, *Transmission Agency of N. Cal. v. FERC*, 628 F.3d 538, 549–52 (D.C. Cir. 2010); *Black Oak Energy, LLC*, 725 F.3d at 239–41.

152. *Transmission Agency of N. Cal.*, 628 F.3d at 550. (citing *Alcoa Inc. v. FERC*, 564 F.3d 1342, 1347 (D.C. Cir. 2009)).

153. *Id.* at 552–55.

154. Opponents may also make undue discrimination arguments about any proposed cost allocation methodology. That issue is not addressed in this article.

rules in 2011.¹⁵⁵ In its order, FERC first summarized the general principle that “according different treatment to different classes of entities subject to our jurisdiction does not amount to undue discrimination under the FPA when the classes are not similarly-situated.”¹⁵⁶ It then explained that treating renewable energy resources differently by exempting them from the minimum-offer price rule was not unduly discriminatory because “wind and solar resources have different characteristics than [combustion turbines] and [combined cycles].”¹⁵⁷ Moreover, variable renewable resources are “a poor choice for any entity attempting to suppress capacity prices” and PJM’s approach was “pragmatic and reasonable.”¹⁵⁸

Reviewing FERC’s order, the Third Circuit concluded that “FERC fully explained its reasons for approving PJM’s proposal to subject gas-fired resources to the MOPR while exempting other types of generation.”¹⁵⁹ According to the Third Circuit, FERC is not strictly prohibited from discriminating against or in favor of renewable resources.

In a case currently pending before the D.C. Circuit, petitioning environmental organizations argue that PJM’s capacity market rules unduly discriminate against renewable energy and demand response resources.¹⁶⁰ Their claim is that PJM’s rules (which were approved by FERC) “unduly discriminate against an entire class of clean energy resources by conditioning participation in the capacity market on an arbitrary and unnecessary annual performance requirement that will largely exclude them.”¹⁶¹ The petitioners explain that the availability of renewable resources and demand response varies over the course of the year.¹⁶² While PJM’s rules once accounted for these “seasonal” resources, the new rules “arbitrarily require[e] every resource in the capacity market to act as a twelve-month resource.”¹⁶³ If the court reaches the merits on this issue, it will further inform the legal analysis of IMAPP proposals. There is no federal court precedent about RTO market rules unduly discriminating against particular resources in this way.

That said, there is no clear legal reason why FERC must conclude that an RTO market mechanism for procuring zero-emission generation capacity or energy is unduly discriminatory. FERC has stated that it “recognize[s] that market design and rules need not be identical among the regions and may instead reflect the unique characteristics of the markets as necessary.”¹⁶⁴ In the 2011 PJM order,

155. *PJM Interconnection LLC*, 137 F.E.R.C. ¶ 61,145 (2011).

156. *Id.* at P 109.

157. *Id.*

158. *Id.* at PP 109-10.

159. *N.J. Bd. of Pub. Utils.*, 744 F.3d at 107.

160. Final Joint Opening Brief of Petitioners, *Advanced Energy Mgmt. Alliance v. FERC*, Docket No. 16-1234 (D.C. Cir. Jan. 10, 2017).

161. *Id.* at 71.

162. *Id.*

163. *Id.* at 72 (emphasis removed).

164. *ISO New England Inc. & New England Power Pool Participants Comm.*, 150 F.E.R.C. ¶ 61,065 at P 18 (2015) (citing several FERC orders including *PJM Interconnection LLC*, 119 F.E.R.C. ¶ 61,063 at P 39 (2007) (“[T]he Commission has permitted different just and reasonable rate designs reflective of particular system characteristics and stakeholder input. In this regard, we have stated our deference to regional preferences a number of times.”)).

FERC recognized that it is not required to treat capacity as an undifferentiated commodity, and specifically invited RTOs to submit capacity market rules that “explicitly recognize . . . environmental or technological goals.”¹⁶⁵ To rationalize this choice, FERC might conclude, for example, that zero-emission resources are not “similarly situated” to other resources, whether because they are required by state policy, diversify the grid’s fuel mix, or based on other factors.

Opponents of a carbon adder may have a stronger undue discrimination claim than opponents of RTO procurement mechanisms. While a well-designed procurement program would presumably benefit eligible resources, other resources may not be directly affected, at least in the short term, and an RTO could include counteracting measures. A carbon adder, however, is essentially a payment from owners of emitting resources to owners of emission-free resources. By definition, such a fee discriminates, but whether that discrimination is “undue” is a separate matter.

In determining whether a specific tariff unduly discriminates, FERC has examined costs, technical characteristics of various resources, and the effects on competition. Given this array of factors, and others it might consider, FERC has discretion to conclude that an IMAPP proposal is not unduly discriminatory. At the same time, FERC’s own precedent suggests that it should be careful not to prefer particular resources or state policies. Consistent with its standard of review under section 205, FERC should defer to the tariff filer on the choice of state policies and resources to include.

D. Analysis of Specific IMAPP Proposals

1. Reforming the Forward Capacity Market (FCM)

NEPOOL participants have explained that IMAPP proposals to reform the FCM can be broadly categorized as intended either to protect the current market from state-mandated renewables or to facilitate the integration of zero-emission resources into the ISO-NE markets.¹⁶⁶

NRG’s “Two-Tier FCM Pricing” proposal is an example of the former. Its purpose is to “enable states to pursue public policy objectives” while also “protecting price formation / competitive signals in the [FCM].”¹⁶⁷ FERC approval would appear consistent with FERC’s recent approval of an ISO-NE capacity market construct that exempted certain state-mandated renewable resources as well as other FERC approvals of minimum-offer price rules. It appears legally less controversial than the latter type of proposal because the facts appear more similar to previous FERC approvals of capacity market rules.

CLF’s “Carbon Integrated Forward Capacity Market” (FCM-C) proposal is an example of the latter. The FCM-C adds to the capacity market construct a

165. 137 F.E.R.C. ¶ 61,145 at P 90.

166. See, e.g., Fuller, *supra* note 137, at 2 (differentiating between IMAPP proposals that “accommodate” and those that “achieve” state policy objectives); Sipe, *supra* note 137, at 2 (distinguishing between IMAPP proposals that “advance” state policies and those that are “purely defensive reforms designed to protect price formation”).

167. NEPOOL, *supra* note 93, at 1.

procurement mechanism for zero-emission credits (ZEC).¹⁶⁸ A ZEC could represent the environmental attributes of one MWh generated by a non-emitting resource, or it could denote a commitment to sell a specific quantity of zero-emission energy in the ISO-NE energy markets.¹⁶⁹ As discussed below, the ZEC procurement mechanism is legally defensible but nonetheless raises questions about FERC jurisdiction.

In general, reforming the capacity market so that it accounts for renewable energy or CO₂ emission goals appears to have less legal risk than creating an FCEM. As discussed above in section II.A, “[w]here capacity decisions about an interconnected bulk power system affect FERC-jurisdictional transmission rates for that system without directly implicating generation facilities, they come within the Commission’s authority.”¹⁷⁰

Over the past decade, FERC has approved multiple capacity market designs in PJM, ISO-NE, and NYISO. Evaluating under section 205, FERC is typically deferential to RTO capacity market proposals, and has a nearly perfect record defending its orders on capacity market design in federal court.¹⁷¹ Challengers of an IMAPP capacity market proposal would therefore have a particularly tall task.

While a capacity market construct that values zero-emission resources is certainly a new wrinkle, and would undoubtedly face legal objections, FERC has twice invited such proposals from RTOs. In 2011, FERC approved new rules for PJM’s Reliability Pricing Model (RPM) capacity market, removing tariff provisions that enabled the participation of generators that were supported by New Jersey and Maryland law.¹⁷² FERC stated that the tariff “does not interfere with states or localities that, for policy reasons, seek to provide assistance for new capacity entry if they believe such expenditures are appropriate for their state.”¹⁷³ FERC further explained that RPM

has no feature to explicitly recognize, for example, environmental or technological goals, nor does it contemplate reliability concerns beyond a three-year forecast. If PJM market participants agree that RPM should account for resource attributes that reflect broader objectives than three-year forward reliability, then PJM and its stakeholders should begin a process to consider how to incorporate these features into RPM’s market design. In this way, all capacity resource suppliers will be able to receive a non-discriminatory market clearing price that reflects these values in addition to reliability.¹⁷⁴

168. Robert Stoddard, et al., Conservation Law Foundation, Presentation: FCM-C Mechanics at 7 (Oct. 21, 2016), http://nepool.com/uploads/IMAPP_20161021_CLF_FCM-C_Mechanics.pdf.

169. *Id.*

170. *Conn. Dep’t of Pub. Util. Control*, 569 F.3d at 484.

171. In *Keyspan-Ravenswood LLC v. FERC*, 348 F.3d 1053 (D.C. Cir. 2003), the court vacated a FERC order approving a NYISO tariff because FERC did not adequately address objections about the tariff’s methodology for calculating a capacity market price cap. Courts have approved FERC capacity market design orders in every other case: *Elec. Consumers Res. Council*, 407 F.3d; *Pub. Serv. Gas & Electric Co. v. FERC*, 324 Fed.Appx. 1 (D.C. Cir. 2009); *Conn. Dep’t of Pub. Util. Control*, 569 F.3d; *TC Ravenswood v. FERC*, 705 F.3d 474 (D.C. Cir. 2013); *TC Ravenswood v. FERC*, 741 F.3d 112 (D.C. Cir. 2013); *N.J. Bd. of Pub. Utils.*, 744 F.3d; *New England Power Generators Ass’n*, 757 F.3d.

172. 137 F.E.R.C. ¶ 61,145.

173. *Id.* at P 89.

174. *Id.* at P 90.

Two months later, FERC invited ISO-NE stakeholders to do the same.¹⁷⁵ These non-binding statements suggest that the FERC Commissioners in 2011/12 did not see a threshold legal issue with creating a capacity market mechanism for resources that meet state “environmental or technological goals.” However, as FERC highlighted in the ISO-NE order, any proposal must be judged based on the record before the Commission and not in the abstract.¹⁷⁶

An IMAPP proposal to include a zero-emission credit (ZEC) procurement mechanism in the capacity market might be opposed by arguments that FERC does not have authority to oversee such a market. A ZEC has been characterized by its supporters both as “the ‘green’ attribute of non-emitting resources,”¹⁷⁷ and as a “new product” awarded for the “produc[tion] [of] megawatt-hours from non-emitting resources.”¹⁷⁸ Under the latter definition, a ZEC sold in the capacity market obligates the seller to produce one MWh of energy from a non-emitting resource at any time during the delivery year.¹⁷⁹ Like the pay-for-performance capacity product that FERC approved in PJM and ISO-NE,¹⁸⁰ a ZEC capacity product would require generators to perform in the energy market. The pay-for-performance orders are currently being challenged in the D.C. Circuit, but the petitioners do not directly oppose FERC’s authority under section 205 to approve the pay-for-performance construct.¹⁸¹ FERC’s authority to approve ZECs appears consistent with its authority to authorize the pay-for-performance construct.

ZECs characterized as “green attributes” are analogous to renewable energy credits (RECs). FERC has asserted jurisdiction over sales of RECs when they are “bundled” with wholesale energy. In a 2012 order approving the addition of a REC annex to a standard-form agreement for the purchase of wholesale power, FERC concluded that

175. *ISO New England & New England Power Pool Participants Comm.*, 138 F.E.R.C. ¶ 61,027 at P 91 (2012).

As the Commission similarly noted in the PJM MOPR Rehearing Order, the FCM has no feature to explicitly recognize, for example, environmental or technological goals, nor does it contemplate reliability concerns beyond a three-year forecast. Parties are free to introduce and develop categorical exemptions or other measures in the stakeholder process. We decline State Commissions and Associated Parties’ request that we clarify beforehand that such an exemption would be just and reasonable. We are not convinced by the argument that such a finding is necessary to “clear[] the way for stakeholders to develop such an approach.” We are furthermore not convinced that we must do so simply because the Commission recently allowed an exemption for renewable resources in PJM. That exemption, unlike the request here, was proposed under section 205 of the FPA. State Commissions and Associated Parties essentially seek a declaratory ruling based on an undeveloped record for an exemption that has not yet been introduced in the stakeholder process. *Id.*

176. *Id.*

177. Stoddard & Elmer, *supra* note 91, at 13.

178. Stoddard, et al., *supra* note 168, at 4.

179. *Id.* at P 22.

180. *PJM Interconnection LLC*, 151 F.E.R.C. ¶ 61,208 (2015); *ISO-New England*, 147 F.E.R.C. ¶ 61,172 (2014).

181. See, e.g., Joint Opening Brief of Petitioners, *Advanced Energy Management Alliance et al., v. FERC*, Docket No. 16-1234, at 68–69 (Sep. 23, 2016); Brief of Petitioner New England Power Generators Association, Inc., *New England Power Generators Ass’n, Inc., v. FERC*, Docket No. 16-1023 (Jul. 18, 2016).

where a wholesale energy sale and a REC sale take place as part of the same transaction, RECs are charges in connection with a jurisdictional service that affect the rates for wholesale energy. Thus, the Commission has jurisdiction over the whole sale energy portion of the transaction as well as the RECs portion of a bundled REC transaction under FPA sections 205 and 206 (regardless of whether the contract price is allocated separately between the energy and RECs).¹⁸²

FERC noted that while there are an “infinite of practices that affect” jurisdictional rates, REC sales “directly affect the rate,” which brings them under FERC jurisdiction.¹⁸³ The Supreme Court recently upheld this “directly affecting” test in connection with FERC’s jurisdiction over demand response.¹⁸⁴ FERC’s REC determination is therefore on solid legal ground. Moreover, it is consistent with FERC’s own precedent. In 1994, FERC determined that if a wholesale sale “requires the use of an emissions allowance that sale, and the cost of the allowances in connection with it, is subject to review under section 205.”¹⁸⁵ FERC’s assertions of jurisdiction were unrelated to the environmental aspects of these instruments but were instead rooted in its role as market regulator.

In its 2012 REC order, and in its 1994 order about emission allowances, FERC disclaimed jurisdiction over RECs and allowances when those instruments are sold independently of FERC-jurisdictional energy sales.¹⁸⁶ According to FERC, “RECs and contracts for the sale of RECs are not themselves jurisdictional facilities subject to the Commission’s jurisdiction under FPA section 201.”¹⁸⁷ Moreover, an “unbundled REC transaction does not affect wholesale electricity rates, and the charge for the unbundled RECs is not a charge in connection with a wholesale sale of electricity.”¹⁸⁸ No court has reviewed FERC’s determinations about RECs and allowances.

That the ZEC is bundled with capacity and not energy may be legally relevant. As discussed above, FERC has asserted jurisdiction over inputs into RTO capacity markets when they directly affect jurisdictional *energy* or *transmission* rates. FERC’s jurisdiction over bundled ZECs, an input into a reformed capacity market, may rest on the argument that ZEC sales directly affect capacity sales, which in turn directly affect wholesale energy sales. One could argue that ZEC sales therefore indirectly affect energy sales, which would fail the direct effects test that the Supreme Court recently approved in *EPISA*.¹⁸⁹

On the other hand, there is little doubt that FERC has broad jurisdiction over capacity markets.¹⁹⁰ Despite the absence of any specific authorization to FERC in

182. *WSPP Inc.*, 139 F.E.R.C. ¶ 61,061 at P 24 (2012).

183. *Id.* at P 22.

184. *Elec. Power Supply Ass’n*, 136 S. Ct. at 787-89.

185. *Edison Elec. Inst.*, 69 F.E.R.C. ¶ 61,344 at 62,289 (1994).

186. 139 F.E.R.C. ¶ 61,061 at PP 18-24.

187. *Id.* at P 21.

188. *Id.* at P 24.

189. *Elec. Power Supply Ass’n*, 136 S. Ct. at 774 (explaining that “a common-sense construction of the FPA’s language, limit[s] FERC’s ‘affecting’ jurisdiction to rules or practices that ‘directly affect the [wholesale] rate.’”).

190. *See generally Hughes*, 136 S. Ct.

the FPA to regulate capacity sales, capacity has been a FERC-jurisdictional product for decades. The direct connection between ZECs and FERC-jurisdictional capacity rates may be sufficient to establish FERC's jurisdiction without tracing that jurisdiction back to its statutory source. Alternatively, this issue can be avoided if FERC concludes that ZECs sold through a capacity market directly affect jurisdictional energy sales. If ZECs are not bundled with energy or capacity, characterizing them as commitments to deliver zero-emission energy rather than as environmental attributes is the more legally sound path.

Regardless of how they are characterized, ZECs would be procured based on market demand.¹⁹¹ Under the proposals outlined in late 2016, ISO-NE would construct a ZEC demand curve with parameters specified by states, and each state would specify (through its regulated utilities) its own ZEC procurement target. FERC would likely have jurisdiction over the demand curve, but it would not have authority to order any market participant to buy or sell ZECs. Like the ISO-NE ICR, the purpose of the ZEC demand curve "is only to locate the price at which market incentives will be sufficient to meet that expected demand."¹⁹² FERC's regulation of the demand curve would "affect[] rates within the Commission's jurisdiction and, in evaluating whether that determination is just and reasonable, the Commission neither regulates generation facilities in violation of section 201 nor runs afoul of any other provision of the Federal Power Act."¹⁹³

2. Including a Carbon Adder in Energy Markets

It is relatively uncontroversial that FERC may approve a CO₂ price tied to allowance or credit requirements, such as those imposed by RGGI and EPA's Clean Power. FERC has recognized that just and reasonable rates may include allowance costs since Congress enacted the sulfur dioxide cap-and-trade program in 1990.¹⁹⁴ More recently, FERC approved a California ISO tariff that incorporates the costs of allowances for that state's economy-wide CO₂ cap-and-trade program.¹⁹⁵ The more difficult legal issues are how to set the price of a carbon adder in the absence of an allowance requirement or state-administered carbon fee, and whether a FERC-jurisdictional rate may include a CO₂ adder that does not relate to a cost actually incurred by market participants.

In a recent article, Joel Eisen argues that FERC has authority to include a carbon adder untethered to a public policy requirement, it draws two conclusions:

191. Stoddard, et al., *supra* note 168, at 8.

192. *Conn. Dep't of Pub. Util. Control*, 569 F.3d at 481.

193. *Id.* at 484.

194. *Edison Elec. Inst.*, 69 FERC ¶ 61,344 at 62,289 (1994); Policy Statement & Interim Rule, *Regarding Rate-making Treatment of the Cost of Emissions Allowances in Coordination Rates*, 59 Fed. Reg. 65,930 (Dec. 22, 1994).

195. *Cal. Indep. Sys. Operator Corp.*, 141 F.E.R.C. ¶ 61,237 at P 29 (2013).

As a general matter, we find that it is reasonable to incorporate the emissions costs of the greenhouse gas allowances into the calculation of generating units' variable costs as calculated in CAISO's tariff. Such a revision is required in order to provide generators a reasonable opportunity to recover their variable energy costs incurred as a result of the California Program. *Id.*

(1) that the adder is relevant to system adequacy or reliability and (2) that the failure to account for CO₂ emissions poses a barrier to the full participation of non-emitting resources in RTO markets.¹⁹⁶ Reviewing more than a century of precedent about regulatory statutes that confer agencies with jurisdiction over practices affecting rates, Eisen concludes that the obligation to account for carbon is a “practice affecting rates” in the same vein as FERC’s regulation of demand response under *EPSA*.¹⁹⁷

For purposes of an IMAPP filing, once FERC concludes that the carbon adder is jurisdictional, it would then have to determine under section 205 that the adder results in just and reasonable rates. The dominant pricing scheme in RTO energy markets relies on locational marginal prices (LMP). LMPs “are designed to reflect the least-cost of meeting an incremental megawatt-hour of demand at each location on the grid, and thus prices vary based on location and time. Each LMP consists of three components: (1) the cost of generation; (2) the cost of congestion; and (3) the cost of transmission losses.”¹⁹⁸ FERC has concluded that LMPs send “accurate price signals” that “encourage more efficient supply and demand decisions in both the short and long run.”¹⁹⁹

Proponents of a carbon price could argue that given current public policy requirements and the likely direction of future emission regulations, LMPs that do not include a carbon price cannot send “accurate” price signals. By motivating investment in resources that make the region’s fuel mix more diverse and enable market participants to meet legal requirements, a carbon adder produces an energy price that more “accurately” reflects both the region’s and the market’s long-term needs. The inaccuracy of current price signals may be particularly acute where states have adopted significant long-term carbon reduction mandates, yet current wholesale prices continue to motivate investment in emitting resources.

Absent a carbon price, FERC might conclude that market participants will continue to invest in natural-gas fired capacity, which, regardless of public policy requirements, will exacerbate the region’s reliance on that fuel. Today, natural gas powers 50% of electricity generated in New England,²⁰⁰ and 90% of new electric generating capacity added to the New England grid since 1999, the year that the ISO-NE wholesale markets began operation, is fossil-fuel fired (nearly all of which is powered by natural gas).²⁰¹ ISO-NE and the New England governors

196. Eisen, *supra* note 114, at 1783, 1835–1843.

197. *Id.* at 1828.

198. *Sacramento Mun. Util. Dist. v. FERC*, 616 F.3d 520, 524 (D.C. Cir. 2010).

199. *New England Power Pool & ISO New England Inc.*, 102 F.E.R.C. ¶ 61,248 at P 12 (2002); *PJM Interconnection*, 110 F.E.R.C. ¶ 61,053 at P 31 (2004) (“Markets should be designed so that as much as possible the market results in efficient prices that send appropriate signals for new entry.”).

200. ISO NEW ENGLAND, INTERNAL MARKET MONITOR: 2015 ANNUAL MARKETS REPORT Tbl. 1-1 (2016), https://www.iso-ne.com/static-assets/documents/2016/05/2015_imm_amr_final_5_25_2016.pdf. In addition, 80% of capacity added in 2015 is natural gas fired. *Id.*

201. U.S. ENERGY INFO. ADMIN., ELECTRICITY: FORM EIA-860 (released Oct. 6, 2016), <https://www.eia.gov/electricity/data/eia860/>.

have expressed concern about the region's reliance on natural gas.²⁰² Assuming support in the record, FERC might conclude that a carbon adder would motivate investment in other types of resources, which would have long-term reliability benefits and mitigate price volatility.

FERC does not have to find that the value of the adder is itself just and reasonable, but rather must conclude that the entire rate (LMP + adder) is just reasonable.²⁰³ Nonetheless, FERC will likely have to approve the amount of the adder that is in the ISO-NE tariff.²⁰⁴ The D.C. Circuit recently explained that under cost-of-service regulation, a court ensures that rates are just and reasonable by

scrutiniz[ing] a utility's rates to ensure a match between cost-causation and cost-responsibility. In the context of a market, we do the same, and our object of scrutiny is the operator's method of fixing a market price, coupled with its system for disbursing any surpluses accumulated because of the LMP method.²⁰⁵

As a matter of economics and science, a carbon adder can be valued to reflect "cost causation and cost responsibility."²⁰⁶ The social cost of carbon represents the "monetary damages" associated with an "incremental increase in carbon emissions in a given year," including damage related to "changes in net agricultural productivity, human health, property damages from increased flood risk, and the value of ecosystem services due to climate change."²⁰⁷ Such damages are currently paid by society and are not reflected in FERC-jurisdictional rates. A carbon adder set to the social cost of carbon would be aimed at forcing market participants to internalize environmental costs, and would not be calibrated to achieve specific outcomes in the wholesale markets.

FERC approval of any carbon adder that is not directly tied to an allowance or credit requirement would be politically controversial. Just as opponents of the Clean Power Plan attacked EPA for "exceed[ing] even the authority that Congress gave to [FERC]" over the electric grid, FERC might be similarly assaulted for

202. ISO NEW ENGLAND, *supra* note 200, at 66 ("One of the most pressing challenges identified in the ISO's Strategic Planning Initiative was the region's reliance on generators fueled by natural gas."); NESCOE, *supra* note 90.

203. *But see* City of Charlottesville v. FERC, 661 F.2d 945, 950 (D.C. Cir. 1981).

Experience has taught that a determination of whether the result reached is just and reasonable requires an examination of the method employed in reaching that result. In examining Commission methodology, "(w)hat is basic is the requirement that there be support in the public record for what was done."

Id. (citing *Permian Area Rate Cases*, 390 U.S. at 791; *Am. Pub. Gas Ass'n.*, 567 F.2d at 1029.)

204. *Cal. Indep. Sys. Operator Corp.*, 155 F.E.R.C. ¶ 61,229 at P 43 (2016).

Decisions on whether to place an item in [an RTO's] tariff or a business practice manual are shaped by the Commission's "rule of reason" policy, which dictates that provisions that "significantly affect rates, terms, and conditions" must be included in the filed tariff.

Id. (citations omitted).

205. *Black Oak Energy, LLC*, 725 F.3d at 237.

206. *Id.*

207. INTERAGENCY WORKING GRP. ON SOCIAL COST OF GREENHOUSE GASES, TECHNICAL SUPPORT DOCUMENT: TECHNICAL UPDATE OF THE SOCIAL COST OF CARBON FOR REGULATORY IMPACT ANALYSIS UNDER EXECUTIVE ORDER 12866, at 3 (Aug. 2016), https://www.whitehouse.gov/sites/default/files/omb/inforeg/scc_tsd_final_clean_8_26_16.pdf.

approving an adder that prices CO₂ emissions higher than EPA's rule.²⁰⁸ Nonetheless, one could argue that the discretion embedded in the just and reasonable standard, along with the FPA section 201 public interest mandate, allow FERC to act as an environmental regulator and approve the internalization of CO₂ emissions costs in jurisdictional rates. Legal precedent does not foreclose FERC from exercising its authority to require that market participants internalize externalities.

In 2000, the D.C. Circuit concluded that the "Supreme Court has never indicated that the discretion of an agency setting 'just and reasonable' rates for sale of a simple, fungible product or service should, or even could, encompass considerations of environmental impact (except, of course, as the need to meet environmental requirements may affect the firm's costs)."²⁰⁹ In that case, the D.C. Circuit held that the environmental concerns of a non-profit representing the Crees people in Quebec did not provide the organization with standing to challenge FERC's grant of market-based rate authority to Quebec Hydro.²¹⁰ But the court based its holding on FERC orders that disclaimed authority to consider environmental issues, and did not hold that the FPA itself precludes FERC from concluding otherwise.²¹¹

That decision explicitly leaves the door open for FERC to change its position. The FPA's ambiguity provides FERC with discretion, and the court's holding is premised on the court's application of *Chevron* deference to FERC's reasonable interpretation of an ambiguous statute. But the court applied that deferential standard of review with approval of FERC's choice, stating that

it seems pointless to weave such [environmental] issues into setting 'just and reasonable' rates for electric power. The environmental issues posed by construction and operation of energy facilities will invariably be reviewed under other provisions; if those reviews (or other forces such as liability risks or firm commitment to environmental quality) cause the utility to incur costs, such costs would feed into the Commission's normal rate calculation.²¹²

If FERC wishes to change its policy it must conclude that accounting for environmental effects is "permissible under the statute."²¹³ As discussed in section I.C, the Supreme Court has tied the FPA's "public interest" mandate to FERC's

208. Opening Brief of Petitioners on Core Legal Issues, *West Virginia et al. v. EPA*, Docket No. 15-1363 (D.C. Cir. Apr. 22, 2016) at 6. The Clean Power Plan does not explicitly price CO₂ emissions, but EPA's technical documents provide the Agency's estimated marginal abatements costs in 2030 under the rule. They vary by state and range from \$0 to \$26 per ton in 2011 dollars. WILLIAM HOGAN, HARVARD UNIV., *ELECTRICITY MARKETS AND THE CLEAN POWER PLAN* 18 (Sept. 21, 2015), https://www.hks.harvard.edu/fs/whogan/Hogan_CPP_092115r.pdf. The social cost of carbon for 2030 ranges from \$16 to \$152 per ton in 2007 dollars, with a "central estimate" of \$50.

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

210. *Id.* at 958.

211. *Id.* at 958-59. The *Crees* decision observes that the FPA is silent on whether FERC may account for environmental effects, but "[f]ollowing the judicial lead, the Commission has affirmatively forsworn environmental considerations." *Id.* at 957. Because FERC had consistently refused to consider environmental issues in ratemaking, the court held that petitioners lacked standing. According to the court, the Crees people were "outside the relevant zone of interests if [] FERC's refusal to consider environmental issues under § 205(a) is valid." *Id.*

212. *Grand Council of Crees*, 198 F.3d at 957.

213. *FCC v. Fox Television Stations*, 556 U.S. 502, 515 (2009).

duty to set just and reasonable rates that “encourage the orderly development of plentiful supplies of electricity.”²¹⁴ This public interest mandate may reinforce FERC’s authority to consider CO₂ emissions as part of its just and reasonable determination, but whether it provides FERC with an independent basis for regulating environmental effects is another matter.

Rather than valuing CO₂ emissions based on their environmental harm, FERC may have a stronger legal argument if a carbon adder is designed to “break down regulatory and economic barriers that hinder a free market in wholesale electricity,”²¹⁵ by achieving some specific outcomes for the energy markets. As in *EPSA*, FERC’s justifications for approving a carbon adder proposal should be “all about, and only about, improving the wholesale market.”²¹⁶ The size of the adder should therefore be premised on goals related to FERC’s core duties under the FPA, such as enhancing competition, dispatching resources that are consistent with the region’s long-term needs, or sending accurate price signals. These goals are independent of the environmental harm caused by CO₂ emissions.²¹⁷

A carbon adder that is not premised on environmental harm and is instead priced to improve the wholesale market may nonetheless be legally problematic if it is found to depart from the cost-causation principle. FERC approves rates as just and reasonable when they “reflect to some degree the costs actually caused by the customer who must pay them.”²¹⁸ As FERC staff explain in a 2014 report, LMPs “ideally would reflect the true marginal cost of production, taking into account all physical and operational system constraints, and fully compensate all resources for the variable cost of providing service.”²¹⁹ Opponents of a carbon adder may argue that a carbon fee untethered to a specific allowance or credit cost does not reflect a generator’s “true marginal cost of production.”²²⁰ CO₂ emissions are an externality,²²¹ LMPs are intended only to reflect costs actually incurred by market participants. Under the cost-causation principle, it may not be justifiable

214. *Nat’l Ass’n for Advancement of Colored People*, 425 U.S. at 671 (1976).

215. *Elec. Power Supply Ass’n*, 136 S. Ct. at 768 (quoting *Morgan Stanley Capital Grp.*, 554 U.S. at 538).

216. *Id.* at 776.

217. The carbon adder discussed in this section is therefore legally distinct from the “emission fees” that FERC rejected in Order No. 888. There, commenters proposed that “the Commission impose a revenue collection measure—in essence a tax on open access transmission.” FERC understood the proposals as attempts to “overturn [EPA] standards or seek to impose more stringent standards.” FERC rejected the proposal, concluding that it “is authorized by the FPA to pass through costs, not to collect additional fees from entities utilizing programs established by the Commission. The payment of emission fees is outside the Commission’s authority under the FPA.” Order No. 888, 61 Fed. Reg. 21,540, 21,682-3 (May 10, 1996). As discussed above, an RTO carbon adder should be designed to achieve compliance with public policies and not to mitigate environmental harms as the Order No. 888 commenters had proposed.

218. *K N Energy, Inc. v. FERC*, 968 F.2d 1295, 1300 (D.C. Cir. 1984).

219. FED. ENERGY REG. COMM’N, OPERATOR-INITIATED COMMITMENTS IN RTO AND ISO MARKETS 1 (Dec. 2014), <https://www.ferc.gov/legal/staff-reports/2014/AD14-14-operator-actions.pdf>.

220. *Id.*

221. An ‘externality’ is “an unpriced, unintentional and uncompensated side effect of one agent’s actions . . . that directly affects the welfare of another agent.” Thomas Sundqvist, *Power Generation Choice in the Presence of Environmental Externalities* (Aug. 2002) (Lulea University of Technology) (citing W.J. BAUMOL & W.E. OATES, *THE THEORY OF ENVIRONMENTAL POLICY* (1988)).

to require market participants to internalize one externality while ignoring the many other externalities of energy production.²²²

In response, FERC might argue that a carbon adder “compensate[s] resources in a manner that reflects the marginal *value* of the resource” to the system.²²³ In setting compensation based on value to the system in Order No. 745, the Commission observed that it “is not limited to textbook economic analysis of the markets subject to [its] jurisdiction, but also may account for the practical realities of how those markets operate.”²²⁴ Consistent with the premise that a carbon adder must be justified by its effects on wholesale markets, FERC might argue that rates set to LMP + adder will appropriately compensate for the benefits of zero-emission energy.

In addition, FERC may also note that it has historically departed from the cost-causation principle and explicitly included non-cost factors in rates. In a case about rates for oil pipelines, the D.C. Circuit explained that “when FERC chooses to refer to non-cost factors in rate setting, it must specify the nature of the relevant non-cost factor and offer a reasoned explanation of how the factor justifies the resulting rates.”²²⁵ “Reliance on non-cost factors has been endorsed by the courts primarily in recognition of the need to stimulate new supplies.”²²⁶ A 1992 FERC policy statement about ratemaking for pipelines and electric utilities asserts that FERC “is free to set rates [above cost-based rates] to provide incentives so long as there is a correlation between the incentive and the result to be induced.”²²⁷ Although FERC then stated that its policy was “not intended for competitive markets,” the Commission is not precluded from reevaluating that determination or concluding that because zero-emission resources are procured outside of RTO markets, there is no competitive RTO market for the purpose of incentivizing zero-emission resources.²²⁸

Approval of a carbon adder as an incentive for the development of a more diverse fuel mix is consistent with the FPA’s “principal purpose of [] en-

222. *Id.* (surveying 63 studies about externalities of electricity production).

223. 134 F.E.R.C. ¶ 61,187 at PP 47, 53 (emphasis added).

224. *Id.* at 45.

225. *Farmers Union Cent. Exch. v. FERC*, 734 F.2d 1486, 1502 (D.C. Cir. 1984) (citations omitted).

226. *Consumers Union v. FPC*, 510 F.2d 656, 660 (D.C. Cir. 1974) (citing *Mobil Oil Corp. v. FPC*, 417 U.S. 283, 314–321 (1974)). Opponents may argue that incentive rates are subject to a heightened standard of review, above and beyond the just and reasonable standard, that requires FERC to demonstrate that the incentive is “in fact needed, and is no more than is needed, for the purpose.” *City of Detroit v. FPC*, 230 F.2d 810, 817 (D.C. Cir. 1955); *see also Elec. Consumers Res. Council*, 407 F.3d at 1236–39 (D.C. Cir. 2005) (citing to cases that petitioner claimed supported a heightened standard of review but rejecting that the tariff at issue provided an “incentive” rate). Judicial precedent is unclear on this issue. This standard has never been applied to a court’s review of RTO market rules. In 2005, opponents of an administratively determined demand curve (ICAP) that was an important input to New York’s capacity market construct argued for this heightened standard of review. *Id.* at 1234–37. The court concluded that the ICAP was not an incentive rate, as petitioners urged. *Id.* at 1240–42. The court did not definitely determine whether an incentive rate formula for an RTO market is subject to heightened review.

227. Policy Statement, *Incentive Ratemaking for Interstate Nat. Gas Pipelines, Oil Pipelines, and Elec. Utils.*, 61 F.E.R.C. ¶ 61,168 at 61,594 (1992).

228. *Id.* at 61,588.

courag[ing] the orderly development of plentiful supplies of electricity . . . at reasonable prices.”²²⁹ The presence of state RPS laws and other renewable policies is evidence that policymakers, and by extension consumers, perceive a scarcity of zero-emission resources. If FERC finds that a carbon adder will address that scarcity, it may be able to conclude that a carbon adder balances consumers’ interests in zero-emissions energy with investors’ interest in a market-based solution.²³⁰

However, a final consideration is that because the carbon adder is not based on actual costs, it may result in “profits too huge to be reconcilable with legislative command” that rates be just and reasonable.²³¹ But the D.C. Circuit has recognized that “market rates are expected and permitted to be higher than marginal costs during times of scarce supply” because “high rates [] serve a critical signaling function: encouraging new development that will increase supply.”²³² In another case, the D.C. Circuit rejected FERC’s denial of a complaint about a NYISO price-mitigation rule because FERC “gave no reason to suppose that [removing scarcity pricing] does not also wreak substantial harm—in curtailing price increments attributable to genuine scarcity that could be cured only by attracting new sources of supply.”²³³ To emulate the effects of scarcity pricing, a carbon adder could be evaluated on a periodic basis and modified to reflect demand for zero-emission energy.

The just and reasonable standard allows FERC to argue that a carbon adder appropriately reflects relevant *values* necessary for the orderly development of the industry. But if the adder is viewed as an incentive rate, there is no clear legal precedent on two issues: (1) whether FERC may approve an adder that is not based on costs actually incurred as an incentive for development of diverse resources, and (2) whether cases about scarcity pricing are analogous to a persistently higher price intended to motivate investment in diverse resources.²³⁴

229. *Nat’l Ass’n for the Advancement of Colored People*, 425 U.S. at 671.

230. *Hope Nat. Gas Co.*, 320 U.S. at 603 (determining whether a rate is just and reasonable must “involve[] a balancing of the investor and the consumer interests”).

231. *Pub. Serv. Comm’n of N.Y. v. FERC*, 589 F.2d 542, 550 (D.C. Cir. 1978).

232. *Blumenthal v. FERC*, 552 F.3d 875, 883 (D.C. Cir. 2009).

233. *Edison Mission Energy, Inc. v. FERC*, 394 F.3d 964 (D.C. Cir. 2005).

234. Unlike a CO₂ adder, scarcity pricing is typically aimed at addressing short-term shortages. *See, e.g., Midwest Indep. Transmission Sys. Operator*, 108 F.E.R.C. ¶ 61,163 at 382-85 (2004); *N.Y. Indep. Sys. Operator, Inc.*, 103 F.E.R.C. ¶ 61,339 (2003); *ISO New England*, 104 F.E.R.C. ¶ 61,130 (2003). To the extent a CO₂ adder is similar to scarcity pricing, this would be addressing long-term needs for low-emission resources. Although FERC has not approved a long-term scarcity pricing mechanism, in 2003 PJM submitted to F.E.R.C. a proposal for a “local market auction to address long term scarcity.” *PJM Interconnection*, 107 F.E.R.C. ¶ 61,112 at P 7 (2004). According to PJM, “the auction [was] designed to provide a market-based incentive to retain and attract appropriate levels of investment and that the auction would result in a long-term solution to scarcity and a correspondingly long-term commitment by load to pay the incremental fixed costs of the selected option.” *Id.* at P 65. FERC stated that it was “willing to consider specific proposals to provide an appropriate last resort process such as an RTO/ISO administered auction to create a long-term commitment which can support cost-effective financing where the [scarcity] problem is projected to be a long-term one.” *Id.* at P 21. FERC also noted that the financial community expressed a “clear preference for long-term contracts and/or reliable revenue streams” as opposed to volatile prices in the spot market to support investments that address reliability needs. *Id.* at P 20. The Commission rejected the proposal because it lacked sufficient detail and therefore PJM had “not met its burden to justify that its proposal is just and reasonable.” *Id.* at P 73. FERC, however, remained “open to a last-resort auction that will address long-term reliability problems.” 107 F.E.R.C. ¶ 61,112 at P 74. On rehearing,

In addition, opponents of carbon adder may argue that an adder would be contrary to FERC's longstanding policy of not favoring particular types of electric generation.²³⁵ This argument collapses into the threshold question of whether an IMAPP proposal amounts to impermissible regulation of generation facilities (see section II.A). Proponents would argue that a carbon adder directly regulates wholesale rates and not generation facilities because it would "permit states to develop whatever capacity resources they wish, and to use those resources to any extent that they wish, while . . . prevent[ing] the state's choices from adversely affecting wholesale" reliability or fuel diversity.²³⁶ "Such action falls squarely within FERC's jurisdiction."²³⁷

If the carbon adder is nonetheless viewed as a change of FERC's fuel neutrality policy, FERC "need not demonstrate to a court's satisfaction that the reasons for the new policy are *better* than the reasons for the old one. It suffices that the new policy is permissible under the statute, that there are good reasons for it, and that the agency *believes* it to be better."²³⁸ As discussed, FERC should be able to meet that standard.

3. Creating a Forward Clean Energy Market (FCEM)

An FCEM is a centralized procurement mechanism for emission-free energy. Like the current wholesale auction mechanisms, an FCEM would match utility bids to buy quantities of emission-free energy with generators' offers to sell such energy. NEPOOL participants' proposals vary in how they implement an FCEM.²³⁹

If FERC can conclude that the FCEM will result in just and reasonable rates, there does not appear to be any threshold legal barrier that prevents FERC from so concluding. In evaluating whether a rate is just and reasonable, "the Commission [is] not bound to the use of any single formula or combination of formulae."²⁴⁰ While FERC has consistently approved auction designs premised on LMPs, it may approve other methodologies, so long as they are supported by the evidence. The just and reasonable standard focuses FERC's review on the "result reached, not the method employed" to set the rate.²⁴¹ FERC aims to "enhance competition," a goal that is not narrowly defined by a particular set of equations.

F.E.R.C. reiterated that it would consider approving a long-term reliability auction to address scarcity. 110 F.E.R.C. ¶ 61,053 at P 69.

235. See, e.g., Notice of Inquiry, *Integration of Variable Energy Resources*, 130 F.E.R.C ¶ 61,053 at P 10 (2010) ("Our goal is not to adopt rules that favor one type of supply source over another.")

236. *N.J. Bd. of Pub. Utils.*, 744 F.3d at 98 (3rd Cir. 2014).

237. *Id.*

238. *Fox Television Stations*, 556 U.S. at 515 (emphasis in original).

239. See also NEPOOL, *supra* note 93.

240. *Hope Nat. Gas Co.*, 320 U.S. at 602.

241. *Id.*

Stakeholders have been discussing various FCEM design options. Distinctions include whether an FCEM award includes the energy and environmental attributes or only environmental attributes.²⁴² As discussed in section II.D.1, although no court has explicitly addressed FERC's jurisdiction over environmental attributes, FERC has held that it has jurisdiction over sales of emissions allowances and renewable energy credits (REC) when those instruments are sold with wholesale power. FERC's rationale, recently endorsed by the Supreme Court in its demand response decision, is that when the instrument is sold with its associated energy, the sale of the instrument "directly affects" the FERC-jurisdictional rate.²⁴³ An environmental attributes-only market therefore presents greater legal risk than a market for energy bundled with environmental attributes.

III. INTERACTION WITH STATE CO₂ AND RENEWABLE ENERGY LAWS

A. *Shifting Implementation of State Policy Under the FPA*

Facilitating the achievement of state policies with federally regulated markets has the potential to transform the relationship between state policy and the Federal Power Act. Justice Sotomayor's concurring opinion in *Hughes* lays the groundwork for this approach.²⁴⁴ She begins by noting that the FPA, "like all collaborative federalism statutes, envisions a federal-state relationship marked by interdependence."²⁴⁵ FERC's "central purpose" and one of its "core regulatory duties" under the FPA is to ensure just and reasonable wholesale rates.²⁴⁶ States have the "ability to contribute, within their regulatory domain, to the Federal Power Act's goal of ensuring a sustainable supply of efficient and price-effective energy."²⁴⁷

The states' "ability to contribute" rests in part on FPA section 201's explicit reservation of state authority over generation and distribution facilities and rates of "any other sale." In 1983, the Supreme Court characterized states' "traditional authority" over the industry as encompassing "the need for additional generating capacity, the type of generating facilities to be licensed, land use, and ratemaking."²⁴⁸ In that case, the Court held that California's ban on new nuclear plants was not preempted by the Atomic Energy Act because the ban was motivated by economic reasons that are within the state's purview and not safety issues that are regulated by federal authorities.²⁴⁹

The electricity industry has changed since the Court outlined states' "traditional authority." California's nuclear ban, passed in 1976,²⁵⁰ implicitly assumed that vertically integrated electric utilities build generation, primarily in-state and

242. See also Forward Clean Energy Market Framework Document (Sept. 12, 2016), http://nepool.com/uploads/IMAPP_20160914_Framework_FCEM.pdf.

243. *Elec. Power Supply Ass'n*, 136 S. Ct.

244. *Hughes*, 136 S. Ct. at 1299-300 (J. Sotomayor, concurring).

245. *Id.* at 1300.

246. *Id.*

247. *Id.*

248. *Pac. Gas & Elec. v. State Energy Comm'n.*, 461 U.S. 190, 212 (1983).

249. *Id.* at 212-216.

250. *Id.* at 194.

to serve their own customers. The economic basis for the ban was firmly tied to state authority over vertically integrated utilities, including the rates they charge to in-state consumers. Today, in restructured states, economic considerations about generation capacity are often more closely tied to FERC authority over wholesale rates. Traditional state authority to dictate generation fuel choices has recently been questioned by lawsuits that argue state procurement policies impermissibly intrude on FERC's exclusive regulatory sphere.

In 2016, an Eighth Circuit judge concluded that a state law banning the import of power from new coal-fired generators was preempted by the FPA because the ban amounted to regulation of wholesale sales.²⁵¹ Judge Murphy concluded in a concurring opinion not joined by any other judges that by “directly ban[ning] certain wholesale sales,” the state law “directly conflicts with FERC’s jurisdiction.”²⁵² Long-term contracting statutes and administrative orders have been similarly challenged on FPA preemption theories in federal courts in Connecticut, Maryland, Massachusetts, New Jersey, New York, and Rhode Island.²⁵³ The tension between the FPA’s reservation of state authority over generation facilities and FERC’s duty to ensure just and reasonable wholesale rates is particularly acute in restructured states where state incentives or mandates for preferred types of generation collide with FERC’s regulation of RTO markets.

Integrating public policy in RTO markets allows states to continue enacting laws that require utilities to procure energy from certain types of resources, and to make related choices about environmental and energy goals. The animating purpose of integrating markets and public policy would be to allow market participants to decide how to match legal obligations with market design. State policy

251. *North Dakota v. Heydinger*, 825 F.3d 912, 913 (8th Cir. 2016).

252. *Id.* at 923-27 (J. Murphy, concurring) (finding that Minnesota’s ban on power from new, out-of-state coal-fired power plants regulates wholesale sales and is therefore preempted by the FPA). Judge Colloton filed a separate concurring opinion about preemption under the Clean Air Act. *Id.* at 927-29 (J. Colloton, concurring). He writes that,

[i]nsofar as the Minnesota statute bans wholesale sales of electric energy in interstate commerce, I agree with Part II of Judge Murphy’s opinion that the statute is preempted by the Federal Power Act. . . . Because a State may not regulate wholesale rates, it follows that a State may not impose a complete ban on wholesale sales, effectively forbidding the parties to arrive at *any* mutually agreeable price.

Id. at 928. Confusingly, he then writes that “[t]he Minnesota statute by its terms, however, does not constitute a complete ban on wholesale sales of energy that contribute to or increase statewide power sector carbon dioxide emissions” because it allows for carbon offsets. *Id.* It is thus not entirely clear whether Judge Colloton agrees with Judge Murphy’s conclusion about Minnesota’s law. Regardless, his opinion could be read to support the proposition that a state may not ban wholesale sales from particular types of generators.

253. *Allco Fin. Ltd. v. Klee*, 2014 WL 7004024 (D. Conn. 2014), *aff’d* *Allco Fin. Ltd. v. Klee*, 805 F.3d 89 (2nd Cir. 2015); *Allco Fin. Ltd. v. Klee*, 2016 WL 4414774 (appeal pending); *PPL Energyplus LLC v. Nazarian*, 974 F. Supp. 2d 790 (D. Md. 2013), *aff’d* *PPL Energyplus LLC v. Nazarian*, 753 F.3d 467 (4th Cir. 2014), *aff’d* *Hughes*, 136 S. Ct. 1290; *Town of Barnstable v. Berwick*, 17 F. Supp. 3d 113 (D. Mass. 2014), *remanded by* *Town of Barnstable v. O’Connor*, 786 F.3d 130 (2015); *PPL Energyplus LLC v. Hanna*, 977 F. Supp. 2d 372 (D.N.J. 2013); *aff’d* *PPL Energyplus v. Solomon*, 766 F.3d 241 (3rd Cir. 2014); *Entergy v. Zibelman*, Docket No. 15-cv-00230 (N.D.N.Y.) (voluntarily dismissed by parties in November 2016); *Coalition for Competitive Elec. v. Zibelman*, Docket No. 16-cv-08164 (S.D.N.Y.) (complaint filed in October 2016); *Riggs v. Curran*, 2016 WL 3688431 (D.R.I. 2016) (appeal pending); *see generally* HARVARD ENV’T L POLICY INITIATIVE, STATE POWER PROJECT, <http://www.statepowerproject.org> (last visited Mar. 9, 2017).

mandates, and requirements issued by EPA or other federal regulators, can be inputs into the design process of an RTO market mechanism. Participation should be voluntary, allowing utilities, for example, to bid on whatever quantity of zero-emission energy they need and to procure energy or capacity outside of the RTO construct. Consistent with FERC's demand response orders, states would "retain the last word" and could prohibit utilities from participating,²⁵⁴ but a well-designed mechanism would "provide a carrot that states won't be able to resist eating."²⁵⁵

Jim Rossi argues that "[c]oncurrent jurisdiction can serve as the organizing principle for many modern energy transactions, especially as new technologies and new kinds of energy resources are providing value for the energy system."²⁵⁶ Integrating markets and public policies provides FERC with "an expansive role in setting guiding principles"²⁵⁷ while reorienting traditional state authority over generation facilities so that it is given meaningful effect within RTO markets.

It is worth noting that some current state procurement laws may be incompatible with an RTO procurement mechanism. For example, Massachusetts law requires distribution companies to "jointly and competitively solicit proposals for offshore wind energy generation; and, provided that reasonable proposals have been received, [] enter into cost-effective long-term contracts."²⁵⁸ The law specifies roles for the state energy agency and stipulates that any such contract is subject to approval by the Department of Public Utilities.²⁵⁹ As discussed below in section III.C, while FERC may account for state regulators' views in its administration of a tariff, FERC may not abrogate its statutory duty to maintain just and reasonable rates by acceding to state authority.

B. Would FERC-jurisdictional Procurement Mechanisms Preempt Renewable Portfolio Standards or Other State Procurement Mandates?

The FPA provides FERC with "exclusive jurisdiction over wholesale sales of electricity in the interstate market."²⁶⁰ A court must preempt state laws that "intrude on FERC's authority over interstate wholesale rates."²⁶¹ Courts also preempt state laws that conflict with FERC regulation by "stand[ing] as an obstacle to the accomplishment and execution of [Congress'] full purposes and objectives."²⁶² Under the FPA's system of "interlocking" federal and state jurisdiction, "conflict-

254. *Elec. Power Supply Ass'n*, 136 S. Ct. at 779–80 (approving of FERC's "notable solicitude toward the States" and stating that FERC's demand response rule is a "program of cooperative federalism").

255. *Ill. Commerce Comm'n.*, 721 F.3d at 773.

256. Rossi, *supra* note 110, at 407.

257. *Id.*

258. MASS. GEN. LAWS ch 188, § 12C (2016).

259. *Id.*; *see also* R.I. GEN. LAWS § 39-26.1-3 (2009) (requiring the state's distribution company to annually solicit proposals from renewable energy developers and, if it receives "commercially reasonable" proposals, to enter into long-term contracts that are subject to regulatory approval).

260. *Hughes*, 136 S. Ct. at 1291; *see also Nantahala Power & Light Co.*, 476 U.S. at 966 (1986) (recognizing that Congress "vested" in FERC "exclusive jurisdiction" and "plenary authority over interstate wholesale rates").

261. *Hughes*, 136 S. Ct. at 1290.

262. *Nazarian*, 753 F.3d at 478 (quoting *Crosby v. Nat'l Foreign Trade Council*, 530 U.S. 363, 373 (2000)).

pre-emption analysis must be applied sensitively . . . so as to prevent the diminution of the role Congress reserved to the States while at the same time preserving the federal role.”²⁶³

Utilities with service territories in RTO regions may purchase energy or capacity through RTO auction markets or by negotiating bilateral contracts.²⁶⁴ Renewable portfolio standards, the dominant state policy driving the recent increase in renewable energy,²⁶⁵ have co-existed with FERC-regulated markets for nearly two decades with little significant legal controversy.²⁶⁶ Some states have also passed separate renewable energy procurement laws.²⁶⁷ Consistent with the fundamental premise of integrating public policies in wholesale markets, any FERC-regulated mechanism should be designed to co-exist with state laws.

That said, as *Hughes* demonstrates, FERC regulation can preempt a state procurement program when it “invades FERC’s regulatory turf.”²⁶⁸ The *Hughes* Court “reject[ed] Maryland’s program only because it disregards an interstate wholesale rate required by FERC.”²⁶⁹ In a concurring opinion, Justice Sotomayor explained that FERC approved the PJM auction as the “proper mechanism” to determine just and reasonable rates for wholesale sales to PJM.²⁷⁰ Maryland’s order set a different rate than FERC’s just and reasonable rate for sales to PJM and “thus contravened the goals of the [FPA].”²⁷¹ As the Court concluded three decades earlier, “States may not regulate in areas where FERC has properly exercised its jurisdiction to determine just and reasonable wholesale rates.”²⁷²

The scope of the *Hughes* decision is a matter of debate before federal courts. In federal district court in New York, generators and industry associations claim

263. *Id.* (quoting *Nw. Cent. Pipeline Corp. v. State Corp. Comm’n*, 489 U.S. 493, 515 (1989)); *see also Hughes*, 136 S. Ct. at 1300 (J. Sotomayor, concurring) (because the FPA is a “collaborative federalism statute,” all preemption inquiries must be “particularly delicate”).

264. *Morgan Stanley Capital Grp.*, 554 U.S. at 546–48 (2008); *see also* Notice of Proposed Rulemaking, *Wholesale Competition in Regions with Organized Elec. Mkts.*, 122 F.E.R.C. ¶ 61,167 at P 130 (2008) (“Long-term power contracts are an important element in a functioning electric power market.”).

265. LAWRENCE BERKELEY NAT’L LAB., U.S. RENEWABLES PORTFOLIO STANDARDS: 2016 ANNUAL STATUS REPORT (Apr. 2016), <https://emp.lbl.gov/sites/all/files/lbnl-1005057.pdf> (calculating that “more than half of all growth in renewable electricity (RE) generation (60%) and capacity (57%) since 2000 is associated with state RPS requirements” and that “RPS policies collectively apply to 55% of total U.S. retail electricity sales”).

266. A non-profit organization that advocates for “free-market environmentalism” filed a lawsuit against Colorado regulators, arguing that the state’s renewable portfolio standard (RPS) was per-se illegal. *Energy & Env’t Legal Inst. v. Epel*, 793 F.3d 1169 (10th Cir. 2015). It is the broadest challenge to a state RPS. The lawsuit’s legal theory was that the RPS violated the dormant Commerce Clause. *Id.* The 10th Circuit found the litigant’s legal theory “overinclusi[ve]” and declined undertake the organization’s “audacious invitation” to embark on a “novel lawmaking project” that the court found might require it to strike down an array of state health and safety regulations. *Id.* at 1175. The complaint did not include any preemption claims. Second Amended Complaint, *Am. Tradition Inst. v. Epel*, Docket 11-cv-00859 (D. Col. Jun. 24, 2013), <https://statepowerproject.files.wordpress.com/2014/03/second-amended-complaint.pdf>.

267. *See, e.g.*, HARVARD ENVT’L POLICY INITIATIVE, *supra* note 253.

268. *Hughes*, 136 S. Ct. at 1297.

269. *Id.* at 1299.

270. *Id.* at 1300 (J. Sotomayor, concurring).

271. *Id.*

272. *Miss. Power & Light Co. v. Miss. ex rel. Moore*, 487 U.S. 354, 374 (1988).

that the Public Service Commission's (PSC) requirement that utilities purchase nuclear ZECs at administratively set prices "replace[s] the FERC-determined energy price with a state-determined energy price."²⁷³ Echoing language from *Hughes*, they claim that state regulators have "invade[d] FERC's exclusive regulatory field by directly altering the revenue to be paid to nuclear generators."²⁷⁴ The PSC rebuts this preemption theory, arguing that FERC does not have jurisdiction over the unbundled ZECs at issue.²⁷⁵ Exelon, the primary beneficiary of the ZEC program, adds that Maryland's program at issue in *Hughes* "is nothing like the ZEC Program."²⁷⁶ While Maryland's program required the generator to sell to PJM, New York awards ZECs based on environmental attributes regardless of where or how the electricity is sold.²⁷⁷

In the Second Circuit, a renewable energy developer claimed that *Hughes* should be read even more broadly and asserted that the Supreme Court invalidated Maryland's program because it "compel[led] wholesale sales with State-selected generators."²⁷⁸ While ZEC opponents focus on the effect of the state program on wholesale rates, the litigant in this case interprets *Hughes* to be about state authority to select specific generators. The developer argued that a Connecticut law that requires state regulators to issue an RFP and select renewable energy projects that utilities must then negotiate with for long-term power purchase agreements similarly "compels" wholesale purchases.²⁷⁹

Regardless of the ultimate decisions in these cases, facilitating the achievement of state goals through a FERC-jurisdictional tariff does not appear to increase the preemption risk for current laws. That said, it is not possible to reach a definitive conclusion without knowing the details of the federal mechanism and the state law at issue.

As discussed in section I.B, under section 206 FERC may conclude that rates in an RTO region are unjust and unreasonable or unduly discriminatory. FERC's remedial authority is directed toward utility tariffs, and the Commission would not have authority to preempt state environmental or energy policies under section 206. However, FERC could argue that it has such authority under PURPA section 205, a rarely invoked provision that allows FERC to "exempt electric utilities . . .

273. Complaint, *Coalition for Competitive Electricity v. Zibelman*, Docket No. 16-cv-08164 (S.D.N.Y. Oct. 19, 2016).

274. *Id.*

275. Memorandum of Law in Support of Defendants Motion to Dismiss, *Coalition for Competitive Elec. v. Zibelman*, Docket No. 16-cv-08164 (S.D.N.Y. Dec. 9, 2016); *see also supra* Section II.D.1.

276. Memorandum of Law in Support of Motion to Dismiss of Movant-Intervenors, *Coalition for Competitive Electricity v. Zibelman*, Docket No. 16-cv-08164 at 12 (S.D.N.Y. Dec. 9, 2016).

277. *Id.* at 18.

278. Opening Brief of Appellant Allco Fin. Ltd., *Allco Fin. Ltd. v. Klee*, Docket No. 16-2949 at 6 (2nd Cir. Sept. 28, 2016).

279. *Id.*

from any provision of State law . . . which prohibits or prevents the voluntary coordination of electric utilities.”²⁸⁰ However, that provision limits FERC’s authority to do so if it concludes that the state law “is designed to protect public health, safety, or welfare, or the environment or conserve energy or is designed to mitigate the effects of emergencies resulting from fuel shortages.”²⁸¹

C. *Would an RTO Carbon Adder Preempt RGGI or Other State CO₂ Policies?*

It is well-established that FERC has exclusive jurisdiction to determine whether wholesale rates are just and reasonable.²⁸² If just and reasonable wholesale rates include a carbon adder, an additional carbon adder under state law might “interfere with FERC’s authority by disregarding interstate wholesale rates FERC has deemed just and reasonable.”²⁸³ “States may not seek to achieve ends, however legitimate, through regulatory means that intrude on FERC’s authority over interstate wholesale rates.”²⁸⁴

There is an important practical distinction between RGGI and the Maryland program in *Hughes* that may be legally relevant. The state-mandated payments in *Hughes* were based explicitly on the PJM price, and had the effect of “adjusting an interstate wholesale rate.”²⁸⁵ RGGI requires generators emitting CO₂ to retire an allowance for each ton of emitted CO₂. A New England generator includes the allowance cost in the offer it submits to ISO-NE. The just and reasonable price generated by a competitive ISO-NE auction market thus includes the RGGI allowance price; RGGI does not “adjust” a FERC-approved rate.

Even if RGGI is not preempted under *Hughes*, the Supreme Court’s preemption test in *OneOK* provides another avenue for preemption. At issue in *OneOK* was whether litigants’ claims about natural gas sales under state antitrust law were preempted by the Natural Gas Act.²⁸⁶ The Court concluded that the “target at which the state law aims” determines whether state law is pre-empted and distinguished “between ‘measures aimed directly at interstate purchasers and wholesales for resale, and those aimed at’ subjects left to the States to regulate.”²⁸⁷

The *OneOK* preemption inquiry then turns on whether RGGI is aimed at FERC-regulated wholesale rates or state-regulated CO₂ emissions. Each of the six New England states enacted RGGI by passing legislation in the late 2000s.²⁸⁸

280. 16 U.S.C. § 824a-1(a); 107 F.E.R.C. ¶ 61,271 (2004) (affirming an initial decision finding that FERC may act under PURPA § 205(a) and permit American Electric Power Service Corp. to integrate into PJM over the objection of the Commonwealth of Virginia).

281. 16 U.S.C. § 824a-1(a)(2).

282. See *supra* note 1.

283. *Hughes*, 136 S. Ct. at 1299.

284. *Id.*

285. *Id.* at 1290.

286. *OneOK, Inc.*, 135 S. Ct at 1594.

287. *Id.* at 1599-1600 (emphasis in original) (quoting *N. Nat. Gas Co. v. State Corp. Comm’n of Kan.*, 372 U. S. 84 (1963)).

288. See, e.g., CONN. GEN. STAT. § 22a-200c(b); ME. REV. STAT. tit. 38 § 580-B(4); MASS. GEN. L. c. 21A, § 22(c)(1); N.H. REV. STAT. ANN. § 125-O:8, 21; R.I. GEN. LAWS §23-82-5(c); VT STAT. ANN. Ch. 30 §255(c); REGIONAL GREENHOUSE GAS INITIATIVE, STATE STATUTES & REGULATIONS, <http://rggi.org/design/regulations> (last visited Mar. 9, 2017).

Those laws typically empower state regulators to auction emission allowances and direct how the proceeds must be spent. The laws do not specifically mention ISO-NE markets. As a practical matter, RGGI aims to reduce CO₂ emissions by raising wholesale power generators' costs in proportion to their CO₂ emission rates.

Proponents of both an ISO-NE carbon price and RGGI's continued existence will have to walk a fine line. On the one hand, they will need to argue that RGGI is aimed at reducing emissions, and the fact that it uses a market-based mechanism that "directly affects" wholesale power prices is not relevant to the jurisdictional question. On the other hand, as discussed above, they will also have to argue that the FERC-approved carbon adder is consistent with the FPA's core purposes and serves a purpose other than pollution control to fend off the argument that "[i]t is common ground that if FERC has jurisdiction over a subject, the States cannot have jurisdiction over the same subject."²⁸⁹ As previously discussed, more recent Supreme Court decisions about the FPA conclude that "federal and state powers [are] 'complementary.'"²⁹⁰ The FPA, "like all collaborative federalism statutes, envisions a federal-state relationship marked by interdependence."²⁹¹ It is legally plausible that an ISO-NE carbon adder and RGGI may coexist.

RGGI advocates may also argue that a court should "start with the assumption that the historic police powers of the States were not to be superseded . . . unless that was the clear and manifest purpose of Congress."²⁹² Pollution control is typically considered an "historic police power," and courts may be hesitant to preempt such laws.

IMAPP advocates might mitigate this quandary by designing an ISO-NE carbon adder to account for RGGI. For example, the RGGI allowance price could be subtracted from the FERC-jurisdictional carbon adder to avoid any conflict (assuming the ISO-NE adder is larger than the RGGI price). This mechanism does not completely eliminate the jurisdictional overlap. But the distinction allows proponents of both pricing mechanisms to argue that the RGGI allowance requirement aims at emission reductions while the ISO-NE carbon adder is aimed at achieving outcomes in the wholesale market.

D. May States "Retain Full Control" Over the Implementation of an RTO Tariff Provision?

A September 30, 2016 NESCOE document summarizes three IMAPP proposals that are supported by at least one state. One proposal describes "a wholesale ISO-NE administered market auction or procurement mechanism that one or more states could use, at states' specific direction, as an alternative to individual or joint state procurements and contracts."²⁹³ NESCOE specifies that "states must

289. *Miss. Power & Light Co.*, 487 U.S. at 377 (citing *Nantahala Power & Light Co.*, 476 U.S. at 962–967).

290. *Elec. Power Supply Ass'n*, 136 S. Ct. at 780 (quoting *La. Power & Light Co.*, 406 U.S. at 631).

291. *Hughes*, 136 S. Ct. at 1300 (J. Sotomayor, concurring).

292. *Hillsborough Cty. v. Automated Med. Labs., Inc.*, 471 U.S. 707, 715 (1985).

293. NESCEO, Memorandum: State IMAPP Objections 3 (Sept. 30, 2016), http://nepool.com/uploads/IMAPP_20161006_IMAPP_Objectives_to_NEPOOL_9_30_16.pdf.

maintain full control, as contemplated in state laws, over the definition and implementation of their own state statutory requirements (neither FERC nor ISO-NE may define, interpret, impose or attempt to create or confer authority about the requirements or implementation of state laws).²⁹⁴

While a FERC-jurisdictional tariff may carve out a role for state regulators,²⁹⁵ the tariff could not eliminate the possibility that FERC would assert jurisdiction over that provision and overrule the state. As discussed in sections II, III, and IV, FERC has jurisdiction to approve an ISO-NE tariff that implements an IMAPP proposal if FERC finds that the matters at issue “directly affect” FERC-jurisdictional rates. Once FERC has asserted jurisdiction, it has a statutory duty to ensure that rates are just, reasonable, and not unduly discriminatory. FERC may not disclaim this responsibility by delegating oversight of the tariff to state regulators.²⁹⁶

The precise role state regulators may play in the administration of a FERC-jurisdictional tariff is a matter of ongoing dispute. FERC recently rejected a NYISO tariff proposal that would have allowed state regulators to select projects that address reliability. FERC found that “NYISO’s proposal inappropriately delegates evaluation and selection of [reliability-must-run] alternatives” to state regulators, and concluded that NYISO must be the entity that addresses reliability needs.²⁹⁷ While FERC reiterated that “a state entity ‘can consult, collaborate, inform, and even recommend a transmission project for selection,’”²⁹⁸ the FERC-regulated RTO must be the entity that selects the reliability solution.

FERC similarly rejected an ISO-NE tariff that would have delegated to NESCOE the responsibility of evaluating and selecting public policy-driven transmission upgrades.²⁹⁹ According to FERC, while NESCOE may identify transmission needs driven by public policy, the FERC-jurisdictional RTO must have the obligation “to evaluate and determine whether to select” transmission solutions in

294. *Id.*

295. Order No. 890, *Preventing Undue Discrimination & Preference in Transmission Serv.*, 72 Fed. Reg. 12,265 (2007) (to be codified at 18 C.F.R. pts. 35, 37).

As with any other interested stakeholder, we emphasize that planning must be coordinated with relevant state regulators . . . that wish to participate in the transmission provider’s planning process. . . . We stress that state determinations with respect to retail load will not be second-guessed, but that once those determinations are incorporated into the transmission plan, the transmission planning principles will apply. *Id.*

296. See also *N.W. Cent. Pipeline Corp.*, 489 U.S. at 518 (“The NGA does not require FERC to regulate around a state rule the only purpose of which is to influence purchasing decisions of interstate pipelines, however that rule is labeled.”); *Nat’l Ass’n of Regulatory Util. Comm’rs v. FERC*, 475 F.3d 1277, 1280 (D.C. Cir. 2007).

As FERC’s authority generally rests on the public interest in constraining exercises of market power . . . it is hard to see how the statute could leave FERC weaponless against conduct that might encourage or cloak the running up of unreasonable costs. *Id.*

297. *N.Y. Indep. Sys. Operator Inc.*, 155 F.E.R.C. ¶ 61,076 at PP 31–41 (2016).

298. *Id.* at P 39 (quoting *N.Y. Indep. Sys. Operator, Inc.*, 143 F.E.R.C. ¶ 61,059 at P 79 (2013)).

299. *ISO New England Inc.*, 143 F.E.R.C. ¶ 61,150 (2013) *reh’g denied*, 150 F.E.R.C. ¶ 61,209 (2015).

regional planning for cost allocation purposes.³⁰⁰ The ISO-NE order is currently on review before the D.C. Circuit.³⁰¹

E. Must a FERC-jurisdictional Tariff Premised on State or Federal Policies be Strictly Limited to Identifiable Laws and Regulations?

Put differently, assuming that FERC has authority to approve a tariff premised in part on achieving public policy requirements, must that tariff be limited to achieving renewable energy or CO₂ emission requirements that regulated entities already face under current law? Or may FERC premise its approval on its understanding that the overall direction of public policy is pushing market participants to a lower carbon grid and approve a tariff that facilitates that transformation? For instance, the Conservation Law Foundation (CLF), an IMAPP participant, has proposed capacity and energy market reforms that would facilitate long-term region-wide CO₂ reductions.³⁰² While the reductions are premised on some states' laws, state regulators have not yet defined the power sector's obligations or placed any specific legal obligations on market participants.³⁰³

Cases generally suggest that a FERC order may be premised on the Commission's reasonable predictions about wholesale markets. If FERC concludes, based on states' long term goals, market and technology trends, or other factors, that there is a broad trend toward a low-carbon grid, it may approve a tariff proposal that facilitates achievement of energy and environmental goals that are above and beyond identifiable legal obligations. The Supreme Court upheld a FERC order that was based in part on the Commission's forecast of market developments.³⁰⁴ According to the Court, such "a forecast of the direction in which future public interest lies necessarily involves deductions based on the expert knowledge of the agency."³⁰⁵ It is worth noting that in that case the Natural Gas Act specifically required FERC to determine whether issuing a certificate is in the "present or future public convenience and necessity."³⁰⁶ The FPA has no such language, but courts have since upheld FERC predictions in FPA cases.

For instance, in a case about a utility merger, the D.C. Circuit rejected arguments that FERC's merger conditions should be vacated because they were premised on speculative market developments.³⁰⁷ According to the court, "it is within the scope of the agency's expertise to make such a prediction about the market it regulates, and a reasonable prediction deserves our deference notwithstanding that

300. Brief of Respondent FERC, *Emera Maine, et al. v. FERC*, Docket No. 15-1139, at 22 (D.C. Cir. May 20, 2016).

301. *Id.*

302. Stoddard & Elmer, *supra* note 91.

303. *See also* Kain v. Dept. of Env't'l Prot., 474 Mass. 278 (2016) (concluding that the Global Warming Solutions Act, which requires economy-wide 80% CO₂ reductions by 2050, requires state regulators to set actual limits on emissions rather than aspirational goals and requires regulators to do so). In December 2016, regulators proposed a set of greenhouse gas emission rules for the power sector.

304. *FPC v. Transcon. Gas Pipe Line Corp.*, 365 U.S. 1, 29 (1961).

305. *Id.*

306. *Id.* at 28.

307. *Env't'l Action v. FERC*, 939 F.2d 1057, 1064 (D.C. Cir. 1991).

there might also be another reasonable view.”³⁰⁸ The D.C. Circuit echoed this opinion one year later in its review of a FERC transaction approval, summarizing that “[a]dministrative agencies are afforded wide deference in predicting the likelihood of future events.”³⁰⁹ In a natural gas ratemaking proceeding, the D.C. Circuit similarly stated, with regard to FERC’s prediction about the competitive effects of a rate structure, that “[m]aking such predictions is clearly within the Commission’s expertise, . . . and we find that its prediction here is rationally based on record evidence.”³¹⁰ More generally, the D.C. Circuit upheld an FCC rule in 2006, concluding that “an agency’s *predictive judgments* about areas that are within the agency’s field of discretion and expertise are entitled to particularly deferential review, as long as they are reasonable.”³¹¹ This standard should easily apply to FERC’s regulation of wholesale markets, and specifically to its predictions about the direction of the ISO-NE markets.

Opponents of integrating markets and public policy may argue that predicting future public policies is not “within the Commission’s expertise,” demarcating a plausible limit on this authority that would prevent FERC from accounting for the direction of public policy. However, outcomes in the energy markets that FERC regulates have always been intimately connected to public policies, including environmental policies. Deference to FERC’s “predictive judgments” is rooted not only in the Commission’s technical ratemaking expertise, but also in its understanding of supply and demand, technological capabilities and development, project finance and development, and industry trends. Public policies influence several (if not all) of these factors. FERC’s prediction that public policies will continue to favor zero-emission generation would not be made in vacuum but would be premised on forty years of state and federal policies, including PURPA of 1978, tax credits for renewable resources enacted in 1992 and renewed several times through 2015, state renewable portfolio standards passed beginning in the late 1990s, the Regional Greenhouse Gas Initiative (RGGI) developed by ten states in the 2000s, and the EPA’s Clean Power Plan.

FERC’s predictive judgments must be supported by the record, but FERC may also rely on economic theory. The D.C. Circuit stated that no case law “prevents the Commission from making findings based on ‘generic factual predictions’ derived from economic research and theory.”³¹² Elsewhere, the D.C. Circuit said that FERC “do[es] not need to conduct experiments in order to rely on the prediction that an unsupported stone will fall; nor need they do so for predictions that

308. *Id.* at 1064.

309. *Mich. Pub. Power Agency v. FERC*, 963 F.2d 1574, 1580 (D.C. Cir. 1992) (citing *FCC v. Nat’l Citizens Comm. for Broad.*, 436 U.S. 775, 813–14 (1978)).

310. *E. Tenn. Nat. Gas Co. v. FERC*, 863 F.2d 932, 939 (D.C. Cir. 1988).

311. *EarthLink, Inc. v. FCC*, 462 F.3d 1, 12 (D.C. Cir. 2006) (emphasis added) (citing *FCC v. WNCN Listeners Guild*, 450 U.S. 582, 594 (1981) (upholding FCC rule premised on “predictions about the development of new broadband technologies and about the incentives for increased deployment (and, in turn, increased competition) flowing from an absence of unbundling”)).

312. *Sacramento Mun. Util. Dist.*, 616 F.3d at 530 (citing *Transmission Access Policy Study Grp*, 225 F.3d at 688). There, the D.C. Circuit clarified that “this Court’s rationale for vacating the FERC order at issue in our 1984 decision in *Electric Consumers* was not that the Commission had relied on economic theory, but that it had ‘distorted the economic theory it claimed to apply.’” *Id.*

competition will normally lead to lower prices.”³¹³ The D.C. Circuit will similarly “defer to [FERC’s] reasonable and cogent explanations of predictable economic outcomes.”³¹⁴

There is no precedent that draws a clear line between a “reasonable prediction [that] deserves [a court’s] deference”³¹⁵ and an unsupported assertion that renders FERC’s decision arbitrary and capricious. The cases do not clarify what type of evidence may support FERC’s determination, but it is reasonable to expect courts to be more deferential to FERC’s predictions if they are rooted in its expertise as a market and reliability regulator rather than its understanding of state politics. What is also clear is that any prediction about the direction of public policy and RTO markets must be based on facts. In New England, in addition to discussing decades of public policies, the submittals in the docket could note that power sector CO₂ emissions are at their lowest levels in decades,³¹⁶ and renewable energy continues to expand.³¹⁷ These trends are likely to persist over the next several years due to existing legal requirements on market participants. FERC’s ability to reasonably predict trends beyond this time frame depends, at least in part, on the available facts.

IV. CONCLUSION

A 1935 House Committee report on the FPA concluded that it was “drawn as to be a complement to and in no sense a usurpation of State regulatory authority and contains throughout directions to the Federal Power Commission to receive and consider the views of State commissions.”³¹⁸ Integrating markets and public policies renews this spirit of cooperation between states and FERC.

As the Court recognized eighty years later in *EPSA*, markets regulated by FERC are not “hermetically sealed” from issues under state regulation. The FPA provides FERC with legal authority to approve a wholesale market tariff that connects state authority over generation facilities with FERC’s jurisdiction over wholesale sales in interstate commerce. Integrating markets with public policies offers a path forward that will allow states to meaningfully exercise their historic authority over generation facilities while ensuring that FERC can fulfill its duty of ensuring that wholesale rates are just and reasonable.

313. *Associated Gas Distribs.*, 824 F.2d at 1008.

314. *Black Oak Energy, LLC*, 725 F.3d at 240.

315. *Env’t Action*, 939 F.2d at 1064.

316. ISO NEW ENGLAND, 2014 ELECTRIC GENERATOR AIR EMISSIONS REPORT 31 fig. 5-7 (Jan. 2016), https://www.iso-ne.com/static-assets/documents/2016/01/2014_emissions_report.pdf (showing total emissions each year from 2001 and 2014 and stating that there was a 26% total reduction).

317. See also GORDON VAN WELIE, PRESIDENT, ISO NEW ENGLAND, PRESENTATION: THE TRANSFORMATION OF THE NEW ENGLAND POWER SYSTEM: INFRASTRUCTURE NEEDS AND MARKET IMPLICATIONS 9 (Sept. 28, 2016), https://www.iso-ne.com/static-assets/documents/2016/09/gvw_nec_9_28_2016.pdf (showing expected growth of wind and solar).

318. *Conn. Light & Power Co. v. FPC*, 324 U.S. 515, 525 (1945) (quoting H.R. Rep. No. 1318, 74th Cong., 1st Sess., (1935)).