

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

Carbon Pricing in Organized)	Docket No. AD20-14-000
Wholesale Electricity Markets)	
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Comments of the R Street Institute on the Notice of Proposed Policy Statement

On Oct. 15, 2020, the Federal Energy Regulatory Commission (Commission) issued a notice of proposed policy statement to encourage efforts to incorporate a state-determined carbon price into organized wholesale electricity markets.¹ This followed a Commission-led technical conference held on the subject on Sept. 30, 2020 which responded to a petition by various industry stakeholders and the R Street Institute.

I. Overview of Comments

R Street applauds the Commission for holding the technical conference, especially under challenging circumstances, and seeks to maximize the potential of next steps to improve policy outcomes. The objectives of the proposed policy statement are to 1) “clarify the Commission’s jurisdiction over RTO/ISO market rules that incorporate a state-determined carbon price” and 2) “encourage RTO/ISO efforts to explore and consider the benefits of potential Federal Power Act (FPA) section 205 filings to establish such rules.” R Street fully agrees with the first objective and stresses that the Commission amend the second objective to consider the *net* benefits of state-determined carbon pricing to ensure costs are accounted for.

Further, the Commission should fine-tune its language on what exactly it is encouraging. The Commission can accomplish its implied objective of making sure state and regional stakeholders know that section 205 proposals are not “dead on arrival”—and thus worth their time to explore—without crossing the line of the Commission becoming a *de facto* climate policymaker by promoting carbon pricing outright. In that same vein, the Commission should add an explicit statement that a uniform, FERC-imposed carbon price under section 206 is off the table.

Whether carbon pricing improves economic efficiency—the core objective of any prudent climate and electricity policy—is a function of parameters within and outside the scope of the FPA. Given this, the Commission should seek to set informational requirements pertaining to economic efficiency that exceed the minimum decisional criteria relevant under section 205 of the FPA. In particular, these should account for region-specific economic conditions and preexisting policies which can have profound effects on the marginal net benefits of carbon pricing.

To achieve the Commission’s stated and implied objectives, we stress that a final proposed policy statement:

¹ Federal Energy Regulatory Commission (FERC), *Notice of Proposed Policy Statement on Carbon Pricing in Organized Wholesale Electricity Markets*, Docket No. AD20-14-000, Oct. 15, 2020, p. 1. https://www.ferc.gov/sites/default/files/2020-10/ad20-14-000_0.pdf

1. Retain the proposed clarification of the Commission’s jurisdiction over RTO/ISO market rules which incorporate a state-determined carbon price;
2. Clarify that the Commission encourages RTO/ISO stakeholders to explore the *net* benefits of carbon pricing under any mechanism across a range of alternative state policy configurations;
3. Set information requirements for carbon pricing under section 205 which engrain robust economic efficiency tests and demonstrate harmonization of state policy with wholesale electricity market operations; and
4. Add an explicit statement that a uniform, FERC-imposed carbon price under section 206 of the FPA will not be pursued as a matter of Commission policy.

II. Proposed Information and Considerations

The Commission’s proposed questions are reasonable but incomplete and would benefit from greater specificity. Questions pertaining to price formation should explicitly examine whether a pricing mechanism would cause any divergence between settlement and dispatch outcomes, require modifications to market power mitigation and similar considerations clearly affecting the determination of “just and reasonable” rates. The Commission should also clarify whether it aims to merely evaluate leakage within the electric industry across geographic footprints or also explore intersector linkages, such as how increasing electricity prices in carbon pricing affects the carbon abatement of transportation and industrial process electrification.

The decisional criteria should at least explicitly require a thorough *process* for evaluating economic efficiency and whether the proposal harmonizes state energy policy with wholesale market operation, which have been identified in the literature as key conditions to deem rates “just and reasonable” under FPA requirements.² Some of the measures of accomplishing this—such as the benefits methodology of avoiding the social cost of emissions—are outside of the Commission’s scope, but it can require that economic techniques must generally comport with the peer-reviewed literature. Requiring thorough economic efficiency analysis would ensure quantifiable costs and benefits were evaluated across a range of policy alternatives, which is a staple of economic analysis for regulatory decision making, such as those delineated in Circular A-4 of the Office of Management and Budget.³ This is especially critical to examine the interactive effects between carbon pricing and other states policies, where a matrixed approach could evaluate different carbon pricing options—at least representative price-based versus quantity-based instruments—across sensitivities reflective of state policy options.

A recent study by E3 demonstrates the importance of this approach.⁴ The study found that current state policies in PJM will achieve greenhouse gas reductions at an average cost of \$82/ton by 2030,⁵ which

² Matt Butner, et al., “Carbon Pricing in Wholesale Electricity Markets,” Institute for Policy Integrity, New York University School of Law, March 2020, pp. 24, 29.

https://policyintegrity.org/files/publications/Carbon_Pricing_in_Wholesale_Electricity_Markets_Report.pdf

³ See https://obamawhitehouse.archives.gov/omb/circulars_a004_a-4/.

⁴ Sanderson Hull et. al, “Least Cost Carbon Reduction Policies in PJM,” Energy+Environmental Economics, Oct. 28, 2020. https://epsa.org/wp-content/uploads/2020/10/E3-Least_Cost_Carbon_Reduction_Policies_in_PJM-FINAL.pdf

⁵ Ibid, p. 38. https://epsa.org/wp-content/uploads/2020/10/E3-Least_Cost_Carbon_Reduction_Policies_in_PJM-FINAL.pdf

exceeds the vast majority of authoritative estimates of the social cost of carbon.⁶ These policies project to reduce emissions by 30 percent from 2005 levels by 2030, whereas a carbon price of \$10/ton projects to reduce emissions 50 percent relative to the same baseline.

The difficulty of a Commission review process is that many of the economic efficiency determinants are outside the scope of the Commission under the FPA. Thus, the Commission could require net benefits analysis for informational purposes as a matter of process, even if not for strict decisional criteria. The informational requirements would be critical to ensure that state and regional stakeholders have thoughtfully evaluated carbon pricing under different sets of economic conditions and policy configurations—both within and outside the scope of the FPA—to maximize the likelihood that the most net beneficial policies are pursued.

The questions posed by the Commission also do not address a critical element of carbon pricing efficiency: stability. The Commission correctly notes the importance of technology neutral and transparent emissions price signals, while providing markets certainty to support investment.⁷ The challenge with achieving investor confidence in this signal is that state-determined carbon pricing lacks consistent political commitment between states and, sometimes, within the same state over multiple election cycles.

If RTO carbon pricing rules are constantly in a state of flux, it will introduce artificial regulatory risk and any net revenue projections to generators will be discounted heavily by investors, thus degrading the investment signal. An analogy is how investors discount revenues from capacity markets, given the high frequency and magnitude of revenue effects of constant rule changes. Achieving a durable carbon pricing rule will require extensive state buy-in on the front end and over time. The Commission may wish to consider a rule stability component—perhaps specifying terms on the process for updating a price—that balances the benefits of investment risk reduction with the costs of locking in a suboptimal design.

III. Conclusion

R Street applauds the Commission for holding the technical conference and for the clarity intended by the proposed policy statement. A uniform legal position on a given carbon pricing mechanism may be prudent, but a uniform position on whether such a tool is economically beneficial cannot be determined on a generic basis, nor based entirely under parameters within the FPA. There is not a robust record to suggest that carbon pricing under section 205 would necessarily produce positive or negative net benefits. In fact, carbon pricing in any form only produces positive net benefits under certain conditions.

The obvious path to improve economic efficiency is to phase-in carbon pricing and phase-out distortionary subsidies. This can result in a decrease in costs and emissions while enhancing innovation and reliability benefits. Energy-intensive, trade-exposed industry has already welcomed this concept.⁸ However, it is unclear how the Commission could condition carbon pricing upon changes in other state

⁶ Kevin Rennert and Cora Kingdon, “Social Cost of Carbon 101,” Resources for the Future, Aug. 1, 2019, p. 3. https://media.rff.org/documents/SCC_Explainer.pdf

⁷ FERC, p.11.

⁸ See comments of the Electricity Consumer Resource Council in Devin Hartman, “Is subnational carbon pricing the off-ramp for MOPR?,” *UtilityDive*, June 2, 2020. <https://www.utilitydive.com/news/is-subnational-carbon-pricing-the-off-ramp-for-mopr/579001>.

policies, but it can require a process to thoroughly evaluate the net benefits of variations of state policy configurations. Without such safeguards, there is no way of disciplining carbon pricing proposals to confidently produce outcomes that improve societal welfare.

Before seeking to issue a final policy statement, the Commission should endeavor a process which seeks robust input from all stakeholders, especially states and consumer groups, who were insufficiently represented in the process leading up to the proposed policy statement. State and regional stakeholders are considering a variety of policies with imperfect information. The least the Commission can do is require a high level of information which thoroughly evaluates economic efficiency considerations as a condition of approving a carbon pricing proposal.

RSI respectfully requests the Commission consider the comments contained herein.

Respectfully submitted,

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Nov. 16, 2020