

C O M M E N T

TOO MUCH RISK, TOO LITTLE REWARD

by Kim Smaczniak

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The Federal Energy Regulatory Commission (FERC) is a little-known and too-often ignored federal authority with the power to block or rapidly accelerate the transition to a clean energy future, and is thus indispensable to addressing climate change. Institute for Policy Integrity scholars Bethany A. Davis Noll and Burcin Unel are to be applauded for bringing into focus a regulatory space that is essential to efforts to decarbonize the power sector. Unfortunately, their article focuses exclusively on a silver bullet approach that poses far too much risk for too little reward. Rather than focus on reforms to regional grid operations that undisputedly fall within FERC's regulatory domain and that would level the playing field for renewables and other clean energy technologies and enable them to outcompete polluting generation, the article calls upon FERC to assert authority to regulate carbon pricing in the wholesale markets directly. Internalizing the public harms of carbon pollution in the price of wholesale electricity is a laudable goal. But David Noll and Unel are too sanguine about the perils of FERC's assuming the mantle of carbon cost regulator.

This Comment offers three points of critique to the authors' argument that FERC possesses authority under the Federal Power Act to impose a carbon price in the same manner that it has the power to address other market failures. First, the article downplays the litigation risk. The risk of court reversal is significant, and the opportunity cost of pursuing an untested construction of the Federal Power Act when lower hanging, more certain reforms remain ripe for the picking should not be discounted. Second, the authors do not seriously weigh the threat that FERC's setting of a carbon price as a component of a just and reasonable wholesale rate poses to *state* authority to price carbon or adopt other policies based on the social cost of carbon. State policies have been a key driver of the adoption of clean energy technologies, and the chilling of states' policy innovation would undercut rapid progress toward decarbonization goals.

Finally, the article ignores a central question: Is FERC really the entity we want to take on the role of regulating carbon emission externalities? Carbon pricing, while widely admired by technocrats for its efficiency, leaves much to be desired on other dimensions. On its own, it cannot achieve decarbonization on the time scales necessary, nor does it accommodate concerns about the equitable or political

aspects of climate policy. But as a rate-regulator, FERC's toolbox of regulatory authorities is limited and its hands are tied from more holistic policy considerations. FERC also faces criticism over the influence of incumbent utility interests in agenda-setting and decisionmaking, while the agency remains relatively insulated from accountability to the public. FERC is mismatched to the task of setting the public value of carbon reduction. In short, while the downside risks of this path are high, the rewards may be limited.

I. Will the Courts Buy It?

Davis Noll and Unel contend that FERC can incorporate the cost of carbon into a wholesale market rate because the failure of prices to incorporate the social cost of carbon is a market inefficiency. They further argue that the social cost of carbon is uniquely "tied to" the cost of production of electricity. The direct link between the externality and the cost of producing electricity is essential to their legal theory, because FERC's oversight under the Federal Power Act is limited to wholesale rates and practices "directly affecting" rates.¹ The authors distinguish between carbon externalities and what they term "indirect environmental considerations," which do not have the same direct effect on the marginal cost of production and therefore fall beyond the scope of FERC's regulation of rates. Unlike other environmental or societal harms caused by power plants, the authors explain, the failure to price carbon affects market outcomes on the margins, such as which generators are dispatched in the auction, which in turn directly affect market rates.

But there is nothing unique about carbon in this regard. Any externality that varies based on the output of the plant is equally "tied to" the cost of production of electricity. If that externality is large enough, it matters on the margin and, under the authors' logic, will also "directly affect" rates. All manner of air, water, or land pollution that results from operation of a power plant meets this test. If FERC can use its authority to require carbon pricing, it could also require wholesale markets to internalize, for example, the public costs of coal ash. Coal ash is a toxic waste product of

1. 16 U.S.C. §824d(a); *F.E.R.C. v. Elec. Power Supply Ass'n*, 136 S. Ct. 760, 774 (2016) (reading into the statute a limit on FERC jurisdiction to practices that "directly" affect rates).

coal combustion that imposes tremendous harm to human health and the environment.² It is one of the highest volume forms of industrial waste in the country,³ and it is costly to store or dispose of in a manner that limits public risk.⁴ To the extent that the U.S. Environmental Protection Agency (EPA) or state environmental agencies mandate handling or disposal requirements to minimize the risk of coal ash, these costs are reflected in a generators' operating costs and thus in market prices. But, much like carbon, regulation of coal ash varies widely in its stringency from state-to-state.⁵ Coal plants operating in lax jurisdictions face lower costs, gain a competitive advantage, and will be dispatched more often compared to an operationally equivalent plant located in a stricter jurisdiction. Wholesale prices in this scenario, too, are not socially efficient.

Under Davis Noll and Unel's theory of jurisdiction, FERC rapidly becomes not only the carbon price regulator, but the overseer of any significant market externality. Moreover, in the name of correcting such market inefficiencies, FERC would stray far from its traditional role to take on the tasks of an environmental or public health agency. To determine if wholesale rates adequately internalize the social cost of electricity production and fall within the range of reasonableness, FERC must assess the public harms of the externality. Ultimately, FERC would be obligated to explain how its choice of an estimate of the social cost of an externality is a reasonable one, and to respond to challenges to the underlying methodology or science. While an estimate of the social cost of carbon boils down to a tidy dollar/ton of gas emitted, the figure derives from a deep, cross-disciplinary assessment of decades of scientific study estimating the physical impacts of rising greenhouse gas concentrations and their economic consequences. Likewise, determining whether the social costs of coal ash are adequately internalized would require challenging assessments of the public health risks of various methods of

disposal or treatment, and judgments of the adequacy of different regulatory requirements in mitigating those risks.

Without a principled line to limit FERC's jurisdictional reach, federal courts are likely to be skeptical of a construction of the Federal Power Act that leads FERC to such a fundamentally new role.

II. If FERC Prices Carbon, Can States Continue to Do So?

The authors argue that in implementing its own carbon pricing regime, FERC "would need to tread carefully so as not to intrude on an area of traditional state control." As long as states do not seek to "directly supplant" wholesale rates, the imposition of FERC-administered carbon pricing would not eliminate or "water down" state prerogatives to pursue climate policies that may affect rates. While I would agree with the authors that the best reading of the Federal Power Act's jurisdictional divide is to allow for significant overlap in federal and state domains, with each regulator's choices remaining intact so long as it does not directly regulate, "aim at," or "target" a matter in the other's exclusive purview,⁶ the article underestimates the flood of litigation, risk of court losses, and corresponding uncertainty generated for state decisionmakers that ensues from its proposal.

The most recent U.S. Supreme Court jurisprudence leaves latent uncertainty as to the scope of state actions that are impermissibly "tethered" to a wholesale rate, and therefore preempted by the Federal Power Act.⁷ Although states have held authority over the mix of generation serving its residents for decades prior to the formation of federally regulated markets, many eastern grid operators proposed, and FERC approved, mandatory capacity markets that place under federal authority the setting of prices so as to ensure an adequate supply of electricity in a region.⁸ Much like the authors' theory, FERC asserted authority over the operation of the capacity market as a "practice affecting" electricity rates—an inadequate supply of capacity links directly to the cost of wholesale power.⁹ But in *Hughes v. Talen*, this federal encroachment into the adequacy of supply ultimately led to the holding that Maryland and New Jersey could not provide additional payments beyond the wholesale market clearing price to incent the development of desirable power sources because such actions constituted an invasion of FERC's regulatory turf.¹⁰

2. See U.S. EPA, Hazardous & Solid Waste Management System; Disposal of Coal Combustion Residuals From Electric Utilities, 80 Fed. Reg. 21303 (Apr. 17, 2015); Julia Kravchenko & H. Kim Lyerly, *The Impact of Coal-Powered Electrical Plants and Coal Ash Impoundments on the Health of Residential Communities*, 79 N.C. MED J. 289 (2018) (literature review of 113 peer-reviewed studies document that "people living in close proximity to coal-fired plants had higher rates of all-cause and premature mortality, increased risk of respiratory disease and lung cancer, cardiovascular disease, poorer child health, and higher infant mortality").
3. U.S. EPA *supra* note 2; see also U.S. EPA, *Coal Ash Basics*, <https://www.epa.gov/coalash/coal-ash-basics>.
4. See, e.g., DOMINION ENERGY, COAL COMBUSTION RESIDUALS ASH POND CLOSURE ASSESSMENT: SENATE BILL 1398 RESPONSE (Nov. 2017), <https://www.dominionenergy.com/library/domcom/media/about-us/electric-projects/coal-ash/sb-1398-full-report.pdf?la=en> (costs to address coal ash at just four out of more than 500 ponds nationwide estimated to surpass \$10 billion).
5. Compare Missouri's proposed program, which EPA found did not meet back-drop federal requirements, see Eli Chen, *EPA Says Missouri's Plan to Regulate Coal Ash Ponds and Landfills Is Too Weak*, ST. LOUIS PUBLIC RADIO, <https://news.stpublicradio.org/post/epa-says-missouri-s-plan-regulate-coal-ash-ponds-and-landfills-too-weak#stream/0>, with North Carolina's order requiring Duke Energy to excavate all remaining coal ash impoundments in the state and store the coal ash in lined landfills, North Carolina Dep't of Env't Quality, *DEQ Orders Duke Energy to Excavate Coal Ash at Six Remaining Sites* (Apr. 1, 2019), <https://deq.nc.gov/news/press-releases/2019/04/01/deq-orders-duke-energy-excavate-coal-ash-six-remaining-sites>.

6. See, e.g., Matthew Christiansen & Joshua Macey, *Long Live the Federal Power Act's Bright Line*, 134 HARV. L. REV. (forthcoming 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3591412## (delineating the small set of categories of federal and state actions that impermissibly cross the Federal Power Act's bright-line jurisdictional limits).
7. See *Hughes v. Talen Energy Marketing, LLC*, 136 S. Ct. 1288, 46 ELR 20078 (2016); Emily Hammond, *Hughes v. Talen Energy Marketing, LLC: Energy Law's Jurisdictional Boundaries—Take Three*, GEO. WASH. L. REV. DOCKET (2016).
8. Shelley Welton, *Electricity Markets and the Social Project of Decarbonization*, 118 COLUM. L. REV. 1067, 1080-82 (2018).
9. See *Connecticut Dep't of Pub. Util. Control v. F.E.R.C.*, 569 F.3d 477, 484 (D.C. Cir. 2009) (describing cases reviewing FERC authority to review and allocate capacity charges and set capacity purchase requirements).
10. *Hughes*, 136 S. Ct. at 1297.

Just as *Hughes* unleashed a series of preemption suits against state policies seeking to incentivize zero emissions generation,¹¹ so too would an action by FERC to price carbon. Once the cost of carbon becomes a component of the wholesale rate subject to FERC regulation, litigious industry members will sharpen their knives and come after state policies as impermissibly augmenting the wholesale value of carbon reduction set by FERC. Any state policy aimed at addressing climate change and internalizing the social costs of carbon emissions could be targeted, not only explicit state or regional carbon pricing. Forcing states to guise their climate objectives and emphasize the other social values (jobs, other environmental benefits) advanced by these policies may be manageable, but constrains state policy space. After years of litigation, the dust may settle and state authorities may rightly be vindicated. But those lost years of state policy innovation and climate progress are not costless, particularly given the urgency of climate action.

III. Would FERC Make a Good Carbon Regulator?

FERC is a rate regulator that is limited by statute largely to reviewing rates proposed by public utilities, and only taking on a more proactive role in setting rates where it has the factual record to conclude existing rates are inconsistent with the statute.¹² FERC does not have the tools to do more than adjust rates—it cannot take into account or respond to the broader social, economic, and distributional opportunities and impacts of climate policy.¹³ The response to climate change entails a massive shift in capital away from fossil fuel-based industry toward alternatives; it fundamentally changes job prospects, tax bases, and where fortunes are made. A growing consensus among advocates for climate action demands that climate policies embed equity and prioritize improving the health and well-being of communities disproportionately harmed by fossil fuel generation.¹⁴ In a nutshell, climate policy is political, and the best and most sustainable policies will reflect and respond to that broader context.

Further, pricing carbon in wholesale markets is nowhere near sufficient to ensure the rapid pace of change in the

power sector necessary to avoid dangerous global temperature rise. To show this concretely, consider the New York Independent System Operator (NYISO) proposal to incorporate the social cost of carbon into wholesale market prices within New York state. Analysis of the proposal reveals that, while such pricing produces substantial social welfare benefits, in a given year carbon pricing reduces dependence on gas in the power sector around three percent, and only rising to about seven percent by 2030.¹⁵ That pace of decarbonization is just too slow, given that decarbonization of the transportation and building sectors largely depends on first achieving deep decarbonization of the power sector. Many other policies are needed, from reforms of grid operational rules, to emission standards and mobilization of large-scale public investments, to achieve ambitious decarbonization goals.

FERC cannot offer multi-dimensional climate policy. It cannot reinvest revenues from carbon prices into communities, infrastructure, or innovation. It cannot seek to shift where emissions reductions occur to account for historic injustices and environmental racism. The gains of anointing FERC as the federal carbon cost regulator are modest at best.

Nor is it clear that FERC is positioned to succeed as an ambitious implementer of carbon pricing. FERC lacks much of the expertise needed to independently assess the social costs of carbon or other environmental externalities. FERC tends to be an enclave of bulk power specialists, attracting industry insiders because that is the know-how needed for the job, but which creates challenges to cross-disciplinary collaboration. Further, FERC-regulated markets have been criticized as vulnerable to the influence of incumbent business interests and insulated from public accountability,¹⁶ raising the question whether FERC-administered carbon prices will achieve the scale and ambition needed.

Climate change is urgent, and many and more creative solutions are called for. Yet in the realpolitik, where political administrations and agencies face limited resources and political capital, assessment of the risks and rewards of a path is vital. If setting FERC on the path to pricing carbon in wholesale markets ultimately does not make that cut, I'm not convinced we should be disappointed.

11. See Welton, *supra* note 8, at 1119-22 (describing cases filed in aftermath of *Hughes* and ongoing litigation risks).

12. NRG Power Mktg., LLC v. F.E.R.C., 862 F.3d 108, 114 (D.C. Cir. 2017) (FERC's role under §205 of the Federal Power Act is a "passive and reactive" one (citation omitted)).

13. This is not meant to impugn the power of the regulatory tools FERC does have at its disposal, which can greatly shape investments in transmission and generation that drive decarbonization.

14. See, e.g., Equitable & Just National Climate Platform, *A Vision for an Equitable and Just Climate Future*, <https://ajustclimate.org/index.html>; David Roberts, *At Last, a Climate Policy Platform That Can Unite the Left*, Vox (May 27, 2020), <https://www.vox.com/energy-and-environment/21252892/climate-change-democrats-joe-biden-renewable-energy-unions-environmental-justice>.

15. See Sue Tierney & Paul J. Hibbard, *Clean Energy in New York State: The Role and Economic Impacts of Carbon Pricing in NYISO's Wholesale Markets*, ANALYSIS GROUP 51 (Oct. 3, 2019), <https://www.analysisgroup.com/news-and-events/news/energy-experts-from-analysis-group-document-impacts-of-a-groundbreaking-proposal-for-carbon-pricing-in-new-york/>.

16. See, e.g., Letter to Chairman Chatterjee and FERC Commissioners from trade groups, consumer advocates, and public interest organizations (June 12, 2019), <https://www.nasuca.org/nwp/wp-content/uploads/2019/06/Multi-trade-electricity-consumer-letter-to-FERC-FINAL.pdf> (Regional grid "decision-making processes do not always adequately consider the voices of customers, innovators, and other new entrants to wholesale electricity markets. The processes often favor incumbents, which have resulted in problems with transparency, accountability, and market performance.").