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Editorial Office
230 Park Ave., 7th Floor, New York, NY 10169 (800) 543-6862
www.lexisnexis.com

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New York Proposes Innovative Carbon Pricing for Electricity

By Mark L. Perlis, William L. Massey, and Wilbur C. Earley*

In a singular proposal, acting without any state or congressional mandate, but with the support of State regulatory agencies, the New York Independent System Operator ("NYISO") proposes to require carbon pricing for all power sold in New York State through the NYISO wholesale electricity market. The authors of this article discuss the proposal and the related regulatory issues.

Carbon pricing is seen by many as an effective means of reducing carbon dioxide ("CO_2") emissions from electricity generation. California and several Eastern states have enacted "cap and trade" emission allowance programs, which have forced generators in those states to pay a price for their CO_2emissions. With the Obama Administration's Clean Power Plan not being implemented, there is currently no federal policy in place that would result in carbon pricing for electricity. In a singular proposal, acting without any state or congressional mandate, but with the support of State regulatory agencies, the New York Independent System Operator ("NYISO") proposes to require carbon pricing for all power sold in New York State through the NYISO wholesale electricity market. For the first time, the Federal Energy Regulatory Commission ("FERC") will be called upon to decide whether and how carbon pricing may be incorporated into wholesale electricity market tariffs solely under the authority of the Federal Power Act.

The NYISO carbon pricing proposal[1] must be fully developed and vetted through a stakeholder process that could take one to two years to reach consensus on a tariff amendment that would be submitted to FERC for review and approval. This stakeholder process and the subsequent FERC proceeding will grapple with complex issues of electricity market design and novel jurisdictional and policy issues. The outcome of this process could lead to a

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[*] Mark L. Perlis (mperlis@cov.com), of counsel at Covington & Burling LLP, is an energy and environmental attorney with a broad-based federal regulatory and litigation practice encompassing all aspects of the electric utility industry. William L. Massey (wmassey@cov.com), senior counsel at the firm who served as a Commissioner at the Federal Energy Regulatory Commission, has a broad-based energy regulatory and government affairs practice. Wilbur C. Earley (bearley@cov.com), a non-lawyer senior advisor at the firm, provides analysis and advice on a wide range of federal and state energy regulatory issues.

[1] https://www.nyiso.com/documents/20142/3911819/Carbon-Pricing-Proposal%20December%202018.pdf/72fe5180-ef24-f700-87e5-fb6f300fb82c.

push for the adoption of carbon pricing in other FERC-regulated organized regional electricity markets throughout the nation.

THE NYISO CARBON PRICING PROPOSAL

The NYISO proposes to fix the price of carbon emissions from electricity generation at the "social cost of carbon," which is a measure developed by federal agencies and endorsed by New York State agencies. The social cost of carbon is more than triple the recent market price of CO_2 allowances in state cap and trade programs.

The NYISO operates auction-based wholesale electricity markets, which establish market-clearing prices that all suppliers receive and all wholesale purchasers pay. Suppliers submit bids to the NYISO to provide quantities of electricity at different prices and the highest-priced offer that is needed and accepted to meet electricity demand in each hour sets the single market-clearing price for that hour. Under competitive market conditions, market clearing prices are determined by the marginal costs of production (*i.e.*, generators' fuel costs) of the last increment of supply that clears the market. Today, suppliers' bids include emission allowance costs, but these are a fraction of the social cost of carbon. The NYISO's carbon pricing proposal would require that all suppliers' bids include the social cost of carbon of all of the CO_2 emissions from in-state generation resources that would supply the quantity of power the bids require.

To the extent carbon-emitting resources set the market-clearing electricity price, which they are likely to do for much of the foreseeable future in New York State, electricity prices paid by retail utilities and energy service providers will rise substantially. Some experts predict NYISO wholesale electricity prices could increase by between 50 and 75 percent, although much of the price increase is proposed to be rebated to consumers. Zero-carbon resources, such as wind, solar, and nuclear facilities, will receive the full market clearing price. Carbon-emitting resources, such as coal and natural gas facilities, will have their carbon costs deducted from their market revenues. The aggregate difference (referred to as "Carbon Residuals") between amounts the NYISO collects from all wholesale purchasers and amounts paid to suppliers (reflecting the carbon charge to suppliers) would be rebated in some manner to retail customers.

JURISDICTIONAL AND MARKET DESIGN ISSUES

Does the Federal Power Act Authorize Carbon Pricing?

In the absence of a state or other federal law that imposes carbon costs on electricity generators, FERC and the courts will need to decide whether, acting solely under the authority of the Federal Power Act, FERC may approve and establish the imposition of a carbon price adder on all electricity sold under an

ISO tariff. Some may challenge the carbon price adder as a "tax" that must be enacted by Congress or as an environmental measure beyond the jurisdiction of an economic regulator such as FERC. Others will defend the proposal as a "just and reasonable" measure necessary to establish economically efficient and non-discriminatory wholesale electricity markets. Conversely, it may be argued that the absence of a carbon price is a "practice affecting wholesale electricity rates" that is discriminatory and unjust and unreasonable, which must be corrected by FERC under the Federal Power Act.

Who Sets the Carbon Price?

The NYISO proposes that the New York Public Service Commission would set the social cost of carbon, relying in part on calculations of a federal inter-agency working group that has since been disbanded by executive order.[2] Will FERC allow the authority to establish a component of a wholesale electricity rate to be delegated to a state agency? Will the social cost of carbon be adjusted over time and, if so, by whom and using what standards?

Should Burner Tip or Upstream Carbon Emissions be Priced?

The NYISO proposes that the carbon price be imposed only on CO_2 emissions from combustion at the generating facility, but others may propose that the social cost of carbon should reflect upstream carbon emissions (including methane) associated with fuel extraction and transportation.

Who Determines Exemptions from the Carbon Price?

The NYISO proposes to let state rules determine whether certain types of "clean energy" suppliers could be exempt from carbon pricing.

How Will Carbon Prices be Rebated to Retail Consumers?

The NYISO proposes to allocate any Carbon Residuals back to load-serving entities, which it intends would be rebated to retail customers. However, perhaps because of perceived jurisdictional limitations, the NYISO has not proposed a method for how load serving entities would rebate those Carbon Residuals to retail customers. It is uncertain whether the Federal Power Act permits the NYISO to include in its FERC-approved tariff specific retail rebate requirements and retail customer allocation methods for effectuating rebates.

How to Treat Electricity Imports to and Exports from New York State?

The NYISO proposes to exclude imported electricity from carbon charges and to rebate carbon charges for electricity exports, while acknowledging

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[2] https://www.whitehouse.gov/presidential-actions/presidential-executive-order-promoting-energy-independence-economic-growth/.

potential drawbacks of applying the carbon price only to in-state generation supplying in-state consumption. Extending carbon pricing to imports might raise jurisdictional issues, carbon attribution issues, and complicate scheduling and bidding processes. Nonetheless, stakeholders might ask why, as a policy matter, imports should be excluded from complying with the bidding requirements for electricity that will be consumed in New York State.

How Should Carbon Pricing Take Account of Other State Programs That Incentivize Low Carbon Resources?

The NYISO proposes to allow generators to credit against their carbon price amounts paid for CO_2 emission allowances under the Regional Greenhouse Gas Initiative. The NYISO proposes no adjustment to amounts received by renewable generators that receive Renewable Energy Credits ("RECs") under a State program. Others have advocated that receipt of RECs and the full market clearing price will provide "double counting" of renewables' zero carbon attributes.

There will be many more design issues to be faced in incorporating carbon pricing into the complex NYISO tariff rules governing, bidding, scheduling, price-setting, out-of-market dispatch, and the capacity market. Although the NYISO's carbon pricing proposal is relatively simple in concept, it may prove devilish in the details.