

Forward Energy Attribute Market Working Group

FEAM LEGAL & JURISDICTIONAL ANALYSIS

Overview:

RECS and Status Quo REC Market

Renewable Energy Certificates, (“RECs”) are state-defined products that represent the environmental attributes of one megawatt hour (“MWh”) of renewable energy. A REC is issued for every MWh of electricity generated and delivered to the electric grid from a renewable energy resource. PJM Environmental Information Services (“PJM-EIS”) hosts a REC data base which tracks REC location, emissions, fuel source, and date, as well as REC generation, transactions, and retirements for compliance with state policy. There are two common methods for completing REC transactions: bilateral transactions or use of an auction or exchange platform. Bilateral contracts take the form of Power Purchase Agreements (“PPA”), under which a third-party developer owns, operates, and maintains the generation unit and a customer agrees to purchase the system’s electric output under financial contract bound to a pre-determined price and purchase period. Auctions and REC exchanges are online platforms that provide continuous market exchanges matching demand with RECs as they become available. Today, there are several different platforms that can facilitate such transactions and separate markets existing for each product like: Class (or Tier) I RECs, Class (or Tier) II RECs, SRECs, etc. The REC trading platform runs a “spot” market that continuously matches supply and with demand; REC providers’ prices are subject to any pricing limitations or price assignments that are determined by the state for compliance with RPS requirements.

The Forward Energy Attribute Market

The Forward Energy Attribute Market (“FEAM”) under development in this Working Group would establish a single, regional platform that procures existing state REC products, newly defined regional REC products, and Clean Energy Attribute Credits (“CEACs”). Products supplied in the FEAM can be produced from any generation unit within the PJM footprint, sold/retired subject to locational constraints specified in state-defined products. Market participants include all clean energy buyers, including states themselves or energy suppliers directed by the states, and any voluntary buyers, including corporations or municipalities with clean energy demand. The FEAM will run annually on a three-year forward basis, similar to the auction structure of PJM’s RPM. Given that state-defined products will be traded in the market, in addition to newly-defined regional products, the states are seeking a governance model that allows states to continue to control of state-defined products.

Q&A Legal Structure of FEAM:

1. How is the unbundled product defined?

The unbundled product constitutes a forward promise to deliver any of multiple product options.

Presently, proposed product types include state-defined products such as those defined in current REC laws; regional products, predominantly wind/solar fungible products produced in PJM; clean energy attribute products to include nuclear and other zero emission generation sources.

a. How does this relate to “Targeted and Tethered” as described in *Hughes v. Talen*?

Federal Power Act jurisdiction over electricity sales and related matters is predominantly governed by section 201,¹ and expanded by section 206.² Section 201(a) charges FERC with regulating the transmission of electric energy in interstate commerce and the sale of electric energy at wholesale in interstate commerce. FERC’s authority is expanded in section 206 to include rates, practices, rules, contracts, and other mechanisms that “affect” practices subject to FERC’s jurisdiction. FERC has held that “RECs are state-created and state-issued instruments certifying that electric energy was generated pursuant to certain requirements and standards. Thus, a REC does not constitute the transmission of electric energy in interstate commerce or the sale of electric energy at wholesale in interstate commerce. Therefore, RECs and contracts for the sale of RECs are not themselves jurisdictional facilities subject to the Commission’s jurisdiction under FPA section 201.”³ Under FERC’s expanded ‘affecting’ jurisdiction, “when an unbundled REC transaction is independent of a wholesale electric energy transaction, we conclude, based on available information, that the 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. Thus, an unbundled REC transaction that is independent of a wholesale electric energy transaction does not fall within the Commission’s jurisdiction under sections 201, 205 and 206 of the FPA.”⁴

The present design of a forward market that procures unbundled RECs is not tethered to wholesale markets in a way that would change the general rule that RECs are not FERC jurisdictional under *Hughes*.

b. Is it consistent with the current unbundled REC products which are non-FERC jurisdictional?

The FEAM model under development today, does not bundle attribute sales with the sales of the underlying electricity. While privately defined state and regional attribute credits will be bought and sold in the FEAM, the critical factor is that RECs are unbundled from the sale of the underlying electricity. The other products are regionally defined, agreed upon by states participating in the FEAM, and can be produced anywhere within the PJM footprint. These products would inherit the jurisdiction of the overall FEAM, even if different from the jurisdiction of the state-defined products.

¹ 16 USC 824.

² 16 USC 824e.

³ *WSPP Inc.*, 139 FERC P 61061, ¶24 (April 20, 2012).

⁴ *WSPP*, ¶24.

c. Does the FEAM represent an interstate compact requiring congressional approval?

An interstate compact is a formal agreement between states with the character of a contract between the states, and require the elements of contract formation.⁵ Ultimately, there is no compact between the states; the states are not agreeing to recognize each others' credits. Nor have a group of states formally created a new entity. Nor are the states likely to make promises to each other in this context, but they might individually deal directly with a market administrator. Nevertheless, according to the Supreme Court, “An interstate compact, by its very nature, shifts a part of a state's authority to another state or states, or to the agency the several states jointly create to run the compact.” *Hess v. Port Authority Trans-Hudson Corp.*, 513 U.S. 30, 42 (U.S. 1994). As long as the FEAM does not restrict a state member’s independent political authority or invade Congress’ authority, it will likely not qualify as an interstate compact requiring congressional consent.

2. What is the difference between current REC market and FEAM, specifically a comparison of the tie/interaction with PJM markets?

The current REC market is bilateral only and supports the exchange of attributes after physical operating timeframe (and before state compliance deadlines). The REC market therefore lacks several of the advantages of centralized market functions including support for settlements, lower transaction costs, transparency of prices and volumes, and competitive auctions.

3. How are FERC-jurisdictional rates impacted?

The sale of unbundled RECs and similar products in a FEAM would affect FERC-jurisdictional rates in the same way bilateral and private exchange sales of unbundled RECs on a forward basis do today. Namely, the market-based payments received for selling their environmental or other energy attributes provides certain generators an additional revenue stream, which could decrease FERC-jurisdictional energy and capacity rates. It seems unlikely that the effect of selling unbundled RECs or other attributes products in the FEAM would affect FERC-jurisdictional rates in a way that is fundamentally different from selling RECs outside the confines of that market.

4. What type of governance structure can a CFTC-products regional market take?

A Designated Contracts Market (“DCM”), which is the most likely designation of the Forward Energy Attribute Market (“FEAM”), has the following governance requirements: 1) must have a “fitness standard” for its directors, members, and key personnel to screen out potential bad actors⁶; 2) make and enforce rules for minimizing and resolving conflicts of interest⁷;

⁵ Adriana Forest, *The Approval of Waukesha's Diversion Application Under the Great Lakes-St. Lawrence River Basin Water Resources Compact--Bad Precedent for the Great Lakes*, 41 Can.-U.S. L.J. 69, 71 (2017)

⁶ 7 U.S.C. § 7(d)(15); 17 C.F.R. § 38.800.

⁷ 7 U.S.C. § 7(d)(16); 17 C.F.R. § 38.850.

3) governance arrangements that consider the views of market participants⁸; and 4) recruit individuals from a broad and culturally diverse pool of qualified candidates to serve on its decision-making bodies.

a. Is there a prescriptive administration model?

The CFTC's DCM regulations do not prescribe an *overall* administrative model, but they contain prescriptive requirements as to various administrative elements and units that any DCM administrative model must have. A few examples are listed below:

- A DCM must have compliance and enforcement unit(s) that either monitor the market, audit trades, and enforce market rules directly, or supervises the work of a third-party "regulatory services provider" that performs these functions for the DCM.⁹
- A DCM must have one or more disciplinary panels to adjudicate alleged rule violations, whose members must not also be members of a compliance and/or enforcement unit.¹⁰

b. What requirements does CFTC have for setting up a market?

CFTC regulations contain detailed requirements that DCMs must meet. Generally, CFTC requires DCMs to have capabilities and processes designed to detect, deter, and prevent various forms of market manipulation and abusive trading practices.¹¹ Establishing a DCM requires filing an application with CFTC that demonstrates the proposed DCM meets all applicable CFTC requirements.¹² Once an application is submitted, CFTC must grant or deny the application within 180 days, unless CFTC determines the application is materially incomplete.¹³ If the Commission determines the application is materially incomplete, the running of the 180-day review period is stayed until a completed application is resubmitted, at which point CFTC has 60 days to decide whether to approve or deny the application.¹⁴

5. Can market rules under CFTC jurisdiction evolve?

The CEA expressly provides for the right of DCMs to change their rules or list new types of products at any time.¹⁵ Generally, a DCM can amend its rules or list a new product simply by filing a written certification that the new rule, rule amendment or product complies with the CEA and its implementing regulations with CFTC.¹⁶ Absent action by CFTC, a new rule or product

⁸ 7 U.S.C. § 7(d)(17); 17 C.F.R. § 38.900.

⁹ See 17 C.F.R. § 38.154-155, 38.257.

¹⁰ 17 C.F.R. § 38.702-710.

¹¹ See generally 17 C.F.R. § 38.150-1201.

¹² See 7 U.S.C. § 8(a); 17 C.F.R. § 38.3.

¹³ 7 U.S.C. § 8(a)

¹⁴ *Id.*

¹⁵ See 7 U.S.C. § 7a-2(c).

¹⁶ 7 U.S.C. § 7a-2(c)(1).

listing automatically takes effect 10 days after the certification is filed with CFTC.¹⁷ However, CFTC can stay the implementation of a new rule for up to 90 days under certain conditions, to further explore the proposal. The proposed rule would then take effect at the end of the 90-day period unless the CFTC determines and informs the DCM that the proposed rule is inconsistent with the CEA or its implementing regulations.¹⁸ The CEA explicitly requires CFTC to approve a proposed rule, rule amendment, or new product unless it finds that the proposed rule, rule amendment, or new product would violate the Act or its implementing regulations.¹⁹

c. How do CFTC processes compare to FERC formal process?

Notably, this process shares significant similarities with how an RTO changes its market rules via a Federal Power Act Section 205 filing:

- Similar to a 205 filing, a DCM can file with CFTC to change its rules or list a new product at any time, and absent any action from the regulator the changes take automatic effect.
- Similarly to how an RTO just needs to show its proposed rule is consistent with the statutory just and reasonable standard, a DCM only needs to show that its proposal does not violate the standards or requirements of the CEA and its implementing regulations.

6. Can CFTC change their mind down the line?

CFTC's regulatory remit is to prevent market manipulation and abusive trading practices. Consequently, CFTC could revoke or suspend a FEAM's status as a DCM *only* if it can prove that the FEAM was failing to enforce rules necessary to prevent such behavior, or otherwise violating the CEA or its implementing regulations. More specifically, CFTC can only revoke or suspend a market's designation as a DCM "on a showing that the [DCM] is not enforcing or has not enforced its rules of government" or on a showing that the DCM "or any director, officer, agent, employee thereof, is violating any of the provisions of [the CEA] or any of the rules, regulations, or orders of the [CFTC] thereunder."²⁰ And as noted above, CFTC must allow the trading of any product on a DCM unless the trading of that product would violate the CEA or its implementing regulations.²¹

¹⁷ 7 U.S.C. § 7a-2(c)(2).

¹⁸ 7 U.S.C. § 7a-2(c)(3).

¹⁹ See 7 U.S.C. § 7a-2(c)(5)(A) ("The Commission shall approve a new rule, or rule amendment . . . unless the Commission finds that the new rule, or rule amendment, is inconsistent with this subtitle (including regulations)."); 7 U.S.C. § 7a-2(c)(5)(B) ("The Commission shall approve a new contract or other instrument unless the Commission finds that the new contract or other instrument would violate this Act (including regulations).").

²⁰ 7 U.S.C. § 8(b).

²¹ See 7 U.S.C. § 7a-2(c)(5)(B).

7. Interaction with FERC for a CFTC-jurisdictional market.

d. Do we need FERC's permission to go build the model?

FERC's permission is not needed to build a CFTC jurisdictional model. The RTO Exemption Order noted the CFTC's exclusive jurisdiction "agreements, contracts or transactions traded pursuant to FERC- or state-approved tariff or rate schedules."²² But even in the presence of the CFTC's jurisdiction over these subject matters, the underlying jurisdiction of FERC and state commissions remained.²³ Thus, the CFTC defined its waiver on the condition that "[t]he agreement, contract, or transaction is offered or sold pursuant to a Requesting Party's Tariff and that Tariff has been approved or permitted to take effect by: (1) In the case of the Electricity Reliability Council of Texas ("ERCOT"), the Public Utility Commission of Texas ("PUCT"), or (2) In the case of all other Requesting Parties, [FERC]."²⁴ This is critical, because the CFTC was deferring jurisdiction to the entity that would have had jurisdiction absent the preemption contained in the CEA. As examined by previous analyses, we do not believe forward transactions for the delivery of attributes would be FERC-jurisdictional, and so reversion to FERC is unlikely.

8. What is the process for obtaining a waiver of CFTC jurisdiction, should the states pursue such option?

The Commodity Exchange Act ("CEA") authorizes the CFTC to "exempt any agreement, contract, or transaction (or class thereof)" as well as "any person or class of persons offering, entering into, rendering advice or rendering other services with respect to, the agreement, contract, or transaction" from most of the requirements of the CEA following "notice and [an] opportunity for hearing."²⁵ A party seeking an exemption from CFTC begins the process by filing a petition with CFTC.²⁶ CFTC then issues a proposed order either granting, potentially subject to conditions, or denying the exemption and solicits public comment on

²² RTO Exemption Order, 78 Fed. Reg. at 19881.

²³ *Id.*

²⁴ *Id.* at 19913.

²⁵ 7 U.S.C. § 6(c)(1). Moreover, the provisions of the Act for which the CFTC cannot provide exemptions appear to be limited to provisions applicable to financial commodities and entities involved in their trading. *See id.* § 6(c)(1)(A) (listing various provisions for which CFTC cannot issue exemptions). As CFTC has ruled that "renewable energy credits are nonfinancial commodities," presumably an FEAM trading only futures for RECs and similar products would not be subject to any of these provisions in the first place. Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement," Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 Fed. Reg. 48,207, 48,317 (Aug. 13, 2012) (to be codified at 17 C.F.R. pt. 1, 230, 240, & 241).

²⁶ *See, e.g.*, Final Order in Response to a Petition From Certain Independent System Operators and Regional Transmission Organizations to Exempt Specified Transactions Authorized by a Tariff or Protocol Approved by the Federal Energy Regulatory Commission or the Public Utility Commission of Texas from Certain Provisions of the Commodity Exchange Act Pursuant to the Authority Provided in the Act, 78 Fed. Reg. 19880, 19892 (Apr. 2, 2013) ("RTO Exemption Order").

it.²⁷ It then reviews the public comments and issues a final order either granting or denying the exemption.²⁸

Strictly speaking, such exemptions do not constitute a waiver of jurisdiction and as such technically there is no “grantee” of CFTC’s jurisdiction. That said, a DCM likely needs to be subject to the regulatory oversight of another federal or state agency to secure an exemption from the CEA:

- In order to grant an exemption, the CFTC must first determine that the relevant “requirement should not be applied to the agreement, contract, or transaction for which the exemption is sought and that the exemption would be consistent with the public interest and the purposes of [the CEA].”²⁹
 - According to the CFTC, the relevant public interest lies in “providing a means for managing and assuming price risk, discovering prices, or disseminating pricing information through trading in liquid, fair and financially secure trading facilities.”³⁰ The purpose of the CEA is to serve these interests and to create a system of effective self-regulation of trading facilities, clearing systems, market participants and market professionals . . . to deter and prevent price manipulation or any other disruptions to market integrity; to ensure the financial integrity of all transactions subject to [the CEA] and the avoidance of systemic risk; to protect all market participants from fraudulent or other abusive sales practices and misuses of customer assets; and to promote responsible innovation and fair competition among boards of trade, other markets and market participants.³¹
- Based on the RTO exemption Order, one general rule can be discerned: the CFTC may require another state or federal regulator to be exercising some form of jurisdiction or oversight over any futures market to which it grants an exemption. The CFTC therefore stressed it was an “important factor” that the granted exemptions were “explicitly limited” to transactions “taking place on markets that are monitored by either an independent [market monitoring unit], a market administrator (the RTO, ISO, or ERCOT), or both, *and* a government regulator (FERC or [the Public Utility Commission of Texas]).”³²
- The CFTC must determine that only “appropriate persons” will enter into an “agreement, contract, or transaction” subject to the requested exemption.³³ The CEA

²⁷ See, e.g., *id.* at 19892, 19894.

²⁸ See, e.g., *id.* at 19880, 19912-15.

²⁹ 7 U.S.C. § 6(c)(2)(A).

³⁰ RTO Exemption Order, 78 Fed. Reg. at 19894 (citing 7 U.S.C. § 5(a)).

³¹ *Id.* (quoting 7 U.S.C. § 5(b)).

³² *Id.* (emphasis added).

³³ 7 U.S.C. § 6(c)(2)(B)(i).

lists various entities that constitute “appropriate persons,” including but not limited to any federal, state, or local government or agency thereof, as well as any “corporation, partnership, proprietorship, organization, trust, or other business entity with a net worth exceeding \$1,000,000 or total assets exceeding \$5,000,000.”³⁴ Business entities that do not meet either the net worth or total asset requirements can still qualify as an “appropriate person” if their obligations under any exempted transaction “are guaranteed or otherwise supported by a letter of credit or keepwell, support, or other agreement.”³⁵

- The CFTC must determine that any “agreement, contract, or transaction” subject to the requested exemption “will not have a material adverse effect on the ability of the [CFTC] or any [DCM] or derivatives transaction execution facility to discharge its regulatory or self-regulatory duties.”³⁶

Securing a exemption will likely take significantly longer than submitting an application for DCM status. It took 14 months for the RTOs to receive their requested exemption, whereas CFTC must act on a DCM application within 6 months.

³⁴ 7 U.S.C. § 6(c)(3).

³⁵ 7 U.S.C. § 6(c)(3)(F).

³⁶ 7 U.S.C. § 6(c)(2)(B)(ii).