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I. Introduction

On January 23, 1995, Illinois Power Company (Illinois Power), the Pennsylvania Public Utility Commission (Pennsylvania Commission), and the Edison Electric Institute (EEI) filed comments requesting clarification of the Policy Statement and Interim Rule issued on December 15, 1994.¹

After considering the comments, the Federal Energy Regulatory Commission (Commission) is revising its Policy Statement on the Ratemaking Treatment of the Cost of Emissions Allowances in Coordination Transactions. Specifically, the Commission is revising the Policy Statement to provide that public utilities may require customers to declare, no later than the beginning of the coordination transaction, whether they will pay for the cost of emission allowances reflected in the purchased electric energy or, in the alternative, deliver emissions allowances in time for "true-up,"² and to provide that public utilities may structure arrangements when customers provide allowances so as to remain risk neutral (*i.e.*, neutral as

to risks of non-delivery). The Commission rejects Illinois Power's request to clarify the Policy Statement and Interim Rule to provide that selling public utilities need not designate indices in their rate filings. The Commission also addresses the Pennsylvania Commission's concerns regarding Federal and state jurisdiction over emissions allowance costs in wholesale and retail rates.

II. Public Reporting Burden

The Final Rule would clarify how existing filing requirements apply to public utilities filing amendments to coordination rate schedules to provide for the recovery of emissions allowance costs. Because this Final Rule only clarifies, and does not amend, how existing filing requirements are to be implemented, the public reporting burden for these information collections (including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information) is not estimated to increase the number of hours per response for each public utility currently involved in the filing of rate schedule amendments. Send comments regarding these burden estimates or any other aspect of these collections of information, including suggestions for reducing the burden, by contacting the Federal Energy Regulatory Commission, 941 North Capitol Street NE., Washington, DC 20426 [Attention: Michael Miller, Information Services Division, (202) 208-1415], and to the Office of Management and Budget, Washington, DC 20503 (Attention: Desk Officer for the Federal Energy Regulatory Commission), FAX: (202) 395-5167.

III. Background

On October 14, 1994, EEI filed a petition under section 207 of the Commission's Rules of Practice and Procedure,³ requesting a policy statement regarding the ratemaking treatment of emissions allowances in coordination transactions under the Federal Power Act (FPA). EEI also requested the Commission to clarify that the sale or transfer of emissions allowances does not require Commission authorization under section 203 of the FPA and does not require filing under section 205 of the FPA.

In the Policy Statement, the Commission adopted, with certain modifications to reflect the concerns raised by intervenors, EEI's proposals.

Specifically, the Commission found that it would allow the recovery of incremental costs of emissions allowances in coordination rates whenever the coordination rate also provides for recovery of other variable costs on an incremental basis. If a coordination rate does not reflect incremental cost pricing for other costs, the Commission stated that it would require the seller to propose an alternative costing method for emissions allowances, or demonstrate that any inconsistency between the proposed costing method and the coordination rate does not produce unreasonable results.

In support of these determinations, the Commission made a number of related findings. First, it found that the cost to replace an allowance is an appropriate basis to establish incremental cost. Second, the Commission found that sellers of emissions allowances should be permitted to choose their own index or a combination of indices, if done consistently, in pricing allowances in coordination transactions. Third, the Commission found that the use of incremental costing for emissions allowances should be consistent with the use of incremental costing for economic dispatch decisions, and stated that any differences between incremental costing for coordination sales and dispatch decisions regarding emissions allowances should be explained and reconciled. Fourth, the Commission found that sellers of emissions allowances should explain how they will compute the amount of emissions allowances that will be attributed to each coordination transaction. Fifth, the Commission found that public utilities should provide information to purchasing utilities regarding the timing of opportunities for purchasers to stipulate whether they will purchase or return emissions allowances. The Commission stated that customers that choose to provide allowances in kind should be permitted to do so by the appropriate Environmental Protection Agency (EPA) reporting date,⁴ rather than at the time

¹ Policy Statement and Interim Rule Regarding Ratemaking Treatment of the Cost of Emissions Allowances in Coordination Rates, 59 FR 65930 (December 15, 1994), III FERC Stats. and Regs., Regulations Preambles ¶ 31,009 (1994).

² See *infra* note 4 (describing "true-up" requirements).

³ 18 CFR 385.207.

⁴ On January 30 (or the first subsequent business day) of each calendar year, EPA determines whether companies have the right number of emissions, allowances of appropriate vintage on hand for each ton of sulfur dioxide emitted during the previous calendar year. See Policy Statement and Interim Rule, III FERC Stats. and Regs., Regulations Preambles at 31,201, 31,203 n.18 Utilities must "true up" their emissions allowance accounts by the EPA reporting date so that they will have a sufficient number of allowances on hand to avoid EPA penalties. The penalty for not having the requisite number of allowances on hand by the EPA reporting date is \$2,000 per ton plus surrender of