Carbon Pricing in Organized Wholesale Electricity Markets

AGENCY: Federal Energy Regulatory Commission.

ACTION: Notice of proposed policy statement.

SUMMARY: The Commission is proposing to issue a policy statement to encourage efforts to incorporate a state-determined carbon price in organized wholesale electricity markets.

DATES: Comments are due on or before November 16, 2020; reply comments are due on or before December 1, 2020.

ADDRESSES: Comments, identified by docket number, may be filed electronically at http://www.ferc.gov in acceptable native applications and print-to-PDF, but not in scanned or picture format. For those unable to file electronically, comments may be filed by mail or hand-delivery to: Federal Energy Regulatory Commission, Secretary of the Commission, 888 First Street, NE, Washington, DC 20426. The Comment Procedures Section of this document contains more detailed filing procedures.

FOR FURTHER INFORMATION CONTACT:

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SUPPLEMENTARY INFORMATION:
On September 30, 2020, the Commission convened a technical conference on state-determined carbon pricing in organized wholesale electricity markets operated by regional transmission organizations (RTOs) and independent system operators (ISOs). As discussed further below, the record of that conference identified numerous potential benefits from incorporating a carbon price set by one or more states into RTO/ISO markets. We issue this proposed policy statement to clarify the Commission’s jurisdiction over RTO/ISO market rules that incorporate a state-determined carbon price and to encourage RTO/ISO efforts to explore and consider the benefits of potential Federal Power Act (FPA) section 205 filings to establish such rules.2

I. **Background on State Emissions-Reduction Policies and Commission-Jurisdictional RTO/ISO Markets**

1. States are currently taking a leading role in efforts to address climate change by adopting policies to reduce their greenhouse gas (GHG) emissions. The electricity sector is a frequent focus of those policies. Several states have adopted laws or regulations that

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1 16 U.S.C. § 824d.

2 This proposed policy statement addresses only filings pursuant to FPA section 205 and not proceedings initiated pursuant to FPA section 206. 16 U.S.C. § 824e.
require the substantial or complete decarbonization of the electricity sector in the coming
decades.\textsuperscript{3} Many others have adopted goals or targets to the same effect.\textsuperscript{4}

2. Carbon pricing has emerged as an important, market-based tool in state efforts to reduce GHG emissions, including efforts to reduce GHG emissions from the electricity sector. In this proposed policy statement, we use the term “carbon pricing” to include both “price-based” methods adopted by states that directly establish a price on GHG emissions as well as “quantity-based” approaches adopted by states that do so indirectly through, for example, a cap-and-trade system.\textsuperscript{5} Currently, 11 states impose some version of carbon pricing,\textsuperscript{6} with multiple other states considering adopting a carbon pricing regime.\textsuperscript{7} Those programs include the ten-state Regional Greenhouse Gas Initiative

\textsuperscript{3} E.g., Thirteen states—California, Hawaii, Maine, Maryland, Massachusetts, Nevada, New Jersey, New Mexico, New York, Oregon, Vermont, and Washington—and the District of Columbia have adopted clean energy or renewable portfolio standards of 50% or greater. See C2ES, U.S. State Electricity Portfolio Standards, https://www.c2es.org/document/renewable-and-alternate-energy-portfolio-standards/.


\textsuperscript{5} “Price-based” methods, such as a carbon fee, use an explicit charge on each ton of GHG emitted. “Quantity-based” methods, such as a cap-and-trade system, limit the amount of permissible GHG emissions. Cap-and-trade systems establish a total quantity of GHGs that can be emitted collectively by all entities covered by the policy within a fixed period (a cap). “Allowances” are created for each ton of GHG emissions that can be emitted. Covered entities must obtain one allowance for each ton of GHG emitted. Covered entities obtain allowances from either: (1) initial allocation or auctioning of allowances; or (2) trading of allowances. Carbon prices thus emerge from the initial
(RGGI) in the Northeast and the cap-and-trade program administered by the California Air Resources Board. In addition, numerous entities, including RTOs and ISOs, have begun examining approaches to incorporating a state-determined carbon price in wholesale electricity markets.

3. As with any state regulation of electricity generation facilities, state efforts to reduce GHG emissions in the electricity sector may indirectly affect matters subject to Commission jurisdiction. And while the Commission is not an environmental regulator, under FPA section 205 the Commission may be called upon to review allocation of allowances and the trading of allowances on the secondary market. The term “state-determined carbon price” can refer to a carbon price set through either a single state or multi-state initiative (e.g., RGGI).


proposals that address the rules that incorporate a state-determined carbon price into RTO/ISO markets.

4. RTO/ISO markets already address various matters related to federal and state environmental regulations. For example, the Commission has long permitted generating resources to recover through wholesale rates the costs of complying with environmental regulations, including the costs of emissions pricing regimes.\textsuperscript{13} Permitting generating resources to recover through wholesale rates the costs associated with a state-determined carbon price in RTO/ISO markets is consistent with that precedent.\textsuperscript{14}

\begin{itemize}
  \item [8] Those states are: Connecticut; Delaware; Maine; Maryland; Massachusetts; New Hampshire; New Jersey; New York; Rhode Island; and Vermont. RGGI, Inc., https://www.rggi.org. Pursuant to state legislation enacted in April 2020 and a subsequent state rule, Virginia will join RGGI in 2021. See RGGI, Inc., \textit{RGGI States Welcome Virginia as its CO\textsubscript{2} Regulation is Finalized}, https://www.rggi.org/sites/default/files/Uploads/Press-Releases/2020_07_08_VA_Announcement_Release.pdf.
  \item [10] For example, ISO-NE’s stakeholder discussions regarding carbon pricing (see van Welie Opening Comments at 2-3, Tr. 100:1-6 (van Welie); ISO-NE Pre-Technical Conference Statement at 6-7); NYISO’s carbon pricing draft proposal (see Dewey Opening Remarks at 3-5; Tr. 89:20-90:3 (Dewey); NYISO, Carbon Pricing, https://www.nyiso.com/carbonpriciing); and PJM’s Carbon Pricing Senior Task Force (see Giacomoni Comments at 2-3; Tr. 146:13-147:3 (Giacomoni); PJM, Carbon Pricing Senior Task Force, https://www.pjm.com/committees-and-groups/task-forces/cpstf.aspx).
5. The Commission has also accepted filings to establish wholesale market rules that address how a state-determined carbon price operates within markets that encompass more than one state. As one example, the California Air Resources Board (CARB) administers a multi-sector cap-and-trade program that includes the electricity sector. As part of its Energy Imbalance Market (EIM), the California Independent System Operator (CAISO) has proposed, and the Commission has accepted, tariff provisions to address how resources located outside California offer into the EIM in light of California’s carbon pricing regime. Those rules permit a resource to fashion its offers into the EIM such that they include a carbon price if they are dispatched to serve load in California and not include a carbon price if they are dispatched to serve load in the rest of the EIM.

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12 16 U.S.C. § 824d(a) (“All rates and charges made, demanded, or received by any public utility for or in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable.”) (emphasis added).

13 See Policy Statement and Interim Rule Regarding Ratemaking Treatment of the Cost of Emissions Allowances in Coordination Rates, 59 FR 65,930, at 65,935 (1994) (Policy Statement on Costs of Emissions Allowances) (“We will allow the recovery of incremental costs of emission allowances in coordination rates whenever the coordination rate also provides for recovery of other variable costs on an incremental basis.”); see also Grand Council of Crees v. FERC, 198 F.3d 950, 957 (D.C. Cir. 2000) (holding that just and reasonable rates may account for a seller’s “need to meet environmental requirements,” which “may affect the firm’s costs”); see generally Peskoe Pre-Conference Filing at 1-2 (discussing these orders in greater detail); Konschnik
Similarly, CAISO has also proposed, and the Commission has accepted, measures for addressing resource shuffling in the EIM\textsuperscript{18} by more accurately assessing which resources are dispatched to serve load in California.\textsuperscript{19}

II. Discussion

A. Incorporating a State-Determined Carbon Price in RTO/ISO Markets

6. In this section, we clarify that the Commission has the jurisdiction over RTO/ISO market rules that incorporate a state-determined carbon price in those markets. We also explain that it is the policy of this Commission to encourage efforts to incorporate a state-determined carbon price in RTO/ISO markets.

\textsuperscript{14} See Peskoe Pre-Conference Filing at 1 (“The Commission has recognized that environmental compliance costs are appropriately included in wholesale rates, and there is no basis for the Commission to treat carbon price costs any differently.”) (citing Policy Statement on Costs of Emissions Allowances, 59 FR 65,930 at 65,935).

\textsuperscript{15} See supra n.6.


\textsuperscript{17} Id.

\textsuperscript{18} In this context, CARB determined that CAISO’s initial method for accounting for emissions from EIM resources that serve California load incorrectly assumed that the least-emitting resources served California load, when instead some of those resources would have already been dispatched to serve load outside of California. Therefore, there was a “backfill” of higher-emitting resources to serve non-California load, or a “shuffling” of resources. CARB concluded that, but for California’s demand in the EIM, those higher-emitting resources would not have been dispatched at all and therefore those emissions should be attributed to serving California load. See, e.g., Wolak Comments at 2-3, Hogan Comments at 4-5, Tr. 101:16-24 (Wolak).

1. **Commission Jurisdiction Regarding Rules that Incorporate a State-Determined Carbon Price into RTO/ISO Markets**

7. We clarify that wholesale market rules that incorporate a state-determined carbon price in RTO/ISO markets can fall within the Commission’s jurisdiction as a practice affecting wholesale rates. Whether the rules proposed in any particular FPA section 205 filing do, in fact, fall under Commission jurisdiction is a determination we will make based on the facts and circumstances in any such proceeding. Accordingly, contrary to the suggestion in the Dissent, we are proposing a framework for applying our jurisdiction, not “pre-judging” particular matters or preemptively “dismiss[ing] . . . potential jurisdictional concerns.”

8. In *EPSA*, the Supreme Court articulated a two-part test for evaluating whether a Commission action is within its jurisdiction to regulate practices affecting wholesale rates. First, the activity being regulated must “directly affect” wholesale rates. Although the Court did not exhaustively define what it means to “directly affect” wholesale rates, it noted that the wholesale market rules established in Order No. 745

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20 16 U.S.C. § 824d(a) (“All rates and charges made, demanded, or received by any public utility for or in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable.”) (emphasis added).

21 Dissent at P 5.


23 *Demand Response Compensation in Organized Wholesale Energy Markets*, Order No. 745, 134 FERC ¶ 61,187, order on reh’g & clarification, Order No. 745-A,
“meet that standard with room to spare.”\textsuperscript{24} As the Court explained, those rules address how demand response resources participate in the RTO/ISO markets, including the levels at which they bid and are compensated.\textsuperscript{25}

9. The wholesale market rules that incorporate a state-determined carbon price into RTO/ISO markets can satisfy that “directly affect” standard. Like the rules at issue in Order No. 745, the wholesale market rules that incorporate a state-determined carbon price could, depending on the particular circumstances, govern how resources participate in the RTO/ISO market, how market operators dispatch those resources, and how those resources are ultimately compensated.\textsuperscript{26} As such, those wholesale market rules can affect wholesale rates in essentially the same way described in \textit{EPSA}.

10. Second, \textit{EPSA} explained that the Commission cannot regulate a matter that FPA section 201(b) reserves for exclusive state jurisdiction, “no matter how direct, or

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\item \textsuperscript{24} \textit{EPSA}, 136 S.Ct. at 774.
\item \textsuperscript{25} \textit{Id}. at 774-75.
\item \textsuperscript{26} See, \textit{e.g.}, Tr. 23:3-22 (D. Hill); 28:24-29:8, 52:24-53:13 (Peskoe); D. Hill Comments at 5-7; Peskoe Pre-Conference Filing at 2-3; Price Comments at 8-9; Rossi Pre-Conference Filing at 3. \textit{See generally Transmission Planning and Cost Allocation by Transmission Owning and Operating Public Utilities}, Order No. 1000, 136 FERC ¶ 61,051, at PP 203-224 (2011), \textit{order on reh’g}, Order No. 1000-A, 139 FERC ¶ 61,132, \textit{order on reh’g and clarification}, Order No. 1000-B, 141 FERC ¶ 61,044 (2012), \textit{aff’d sub nom. S.C. Pub. Serv. Auth. v. FERC}, 762 F.3d 41 (D.C. Cir. 2014) (requiring that regional transmission planning processes consider transmission needs driven by public policy requirements (which can include state public policies)).
\end{itemize}
dramatic, its impact on wholesale rates.”27 The Court explained, however, that the effects that wholesale market rules have on retail rates or other matters subject to exclusive state jurisdiction do not, in and of themselves, cause the Commission to exceed its jurisdiction.28 Instead, those effects are the inevitable result of the fact that the FPA divides jurisdiction over the electricity sector between the Commission and the states.29 In turning to the specifics of Order No. 745, the Court concluded that the rule did not regulate retail rates because “every aspect of [the rule] happens exclusively on the wholesale market and governs exclusively that market’s rules” and “the Commission's justifications for regulating demand response are all about, and only about, improving the wholesale market.”30 Under those circumstances, the Court explained, “section 201(b) imposes no bar” on Commission authority.31

11. The wholesale market rules that incorporate a state-determined carbon price in RTO/ISO markets can satisfy this standard as well. Wholesale market rules that

27 EPSA, 136 S.Ct. at 775.

28 Id. at 776 (“[A] FERC regulation does not run afoul of § 824(b)’s proscription just because it affects—even substantially—the quantity or terms of retail sales.”).

29 Id. (“It is a fact of economic life that the wholesale and retail markets in electricity, as in every other known product, are not hermetically sealed from each other. To the contrary, transactions that occur on the wholesale market have natural consequences at the retail level. And so too, of necessity, will FERC’s regulation of those wholesale matters.”).

30 Id.

31 Id.
incorporate a state-determined carbon price into RTO/ISO markets would not regulate a matter reserved exclusively to the states under the FPA, or otherwise displace state authority, including state authority over generation facilities.³² Instead, wholesale market rules that incorporate a state-determined carbon price in RTO/ISO markets can “govern exclusively” the wholesale market and do so for the purpose of improving that market.³³ If so, the wholesale market rules that incorporate a state-determined carbon price could affect matters within state jurisdiction, including a state’s regulation of generation facilities, without running afoul of section 201(b)’s limitation on Commission jurisdiction.³⁴ Under that arrangement, and as in the CAISO EIM example discussed above,³⁵ the state would retain authority over that carbon price as well as other measures for regulating generation facilities. For these reasons, incorporating a state-determined carbon price into RTO/ISO markets would not in any way diminish state authority.

12. Finally, we note that incorporating a state-determined carbon price into RTO/ISO markets could represent another example of the type of “program of cooperative federalism” that the Court noted with approval in EPSA.³⁶ RTO/ISO market rules that incorporate a state-determined carbon price could, as discussed above, improve the


³³ EPSA, 136 S. Ct. at 776.

³⁴ Id.

³⁵ See supra P 6.

³⁶ EPSA, 136 S. Ct. at 779-80.
efficiency and transparency of the organized wholesale markets by providing a market-based method to incorporate state efforts to reduce GHG emissions. Because the decision about the carbon price would be determined by the state—which could select a price of zero, should it choose—state authority would be unaffected, further removing any doubt that rules that incorporate such a state-determined carbon price would comply FPA section 201(b).\textsuperscript{37}

2. **Commission Encouragement of Efforts to Incorporate a State-Determined Carbon Price into RTO/ISO Markets**

13. As noted, on September 30, 2020, the Commission held a technical conference on the integration of state-determined carbon pricing in RTO/ISO markets. Participants at the conference identified a diverse range of potential benefits that could arise from such a proposal. Those benefits include the development of technology-neutral, transparent price signals within RTO/ISO markets and providing market certainty to support investment.\textsuperscript{38} In addition, participants explained that carbon pricing is an example of an

\textsuperscript{37} Id. at 780.

\textsuperscript{38} See Tr. 24:1-3 (D. Hill), 85:17-21 (Bowring), 95:14-16 (Olson), 171:1-10 (White), 177:1-3 (Mukerji), 219:6-25 (Wadsworth), 261:24-262:5 ("From a pure business perspective, clarity and certainty are so important. And for those of us that are involved in making these long-term capital-intensive investments in energy infrastructure, having this mechanism that can provide long-term price signals for investment would be hugely valuable.") (Beane), 264:17-19 (Crane), 278:8-10, 279:10-15 (Segal), 283:17-19 (Wiggins), 300:20-301:12 (Beane), 312:22-313:15 (Beane), 314:14-22 (Crane), 317:11-20 (Segal), 326:17-327:7 (Wiggins).
efficient market-based tool that incorporates state public policies into RTO/ISO markets, without in any way diminishing state authority.\textsuperscript{39}

14. We agree that proposals to incorporate a state-determined carbon price in RTO/ISO markets could, if properly designed and implemented, significantly improve the efficiency of those markets.\textsuperscript{40} Accordingly, we propose to make it the policy of this Commission to encourage efforts by RTOs/ISOs and their stakeholders—including States, market participants, and consumers—to explore establishing wholesale market rules that incorporate state-determined carbon prices in RTO/ISO markets. Although we will review any specific FPA section 205 filing based on the facts and circumstances presented in each proceeding, we encourage interested parties to explore approaches to propose wholesale market rules to incorporate a state-determined carbon price in RTO/ISO markets.

**B. Considerations for Evaluating an FPA Section 205 Proposal to Incorporate a State-Determined Carbon Price in RTO/ISO Markets**

15. The Commission will review any FPA section 205 filing that proposes to establish wholesale market rules that incorporate a state-determined carbon price in RTO/ISO markets based on the particular facts and circumstances presented in that proceeding.

\textsuperscript{39} See, e.g., Tr. 27:7-11, 29:9-24 (Peskoe), 31:15-32:12 (Price), 85:9-21 (Bowring), 200:11-23 (Breidenich).

Nevertheless, certain questions and issues are likely to arise in any such filing. Below, we identify certain information and considerations that, based on the record at the Carbon Pricing Technical Conference, we believe may be germane to the Commission’s evaluation of a section 205 filing to determine whether an RTO/ISO’s market rules that incorporate a state-determined carbon price in RTO/ISO markets are just, reasonable and not unduly discriminatory or preferential. The Commission seeks comment on whether these are the appropriate information and considerations the Commission should take into account or whether different or additional considerations may be or must be taken into account.

a. How, if at all, do the relevant market design considerations change depending on the manner in which the state or states determine the carbon price (e.g., price-based or quantity-based methods)? How will that price be updated?

b. How does the FPA section 205 proposal ensure price transparency and enhance price formation?

c. How will the carbon price or prices be reflected in LMP?

d. How will the incorporation of the state-determined carbon price into the RTO/ISO market affect dispatch? Will the state-determined carbon price affect how the RTO/ISO co-optimizes energy and ancillary services? Are any reforms to the co-optimization rules necessary in light of the state-determined carbon price?

e. Does the proposal result in economic or environmental leakage? How does the proposal address any such leakage?

See Hogan Comments at 4, Wolak Comments at 2, Singh Comments at 2-3. See also Tr. 56:12-57:10 (Price) (generally discussing economic and environmental leakage), Tr. 46:2-18 (Peskoe) (discussing the Commission’s jurisdiction over proposals from public utilities to address leakage).
III. Comment Procedures

16. The Commission invites comments on this Proposed Policy Statement by November 16, 2020 and reply comments by December 1, 2020. Comments must refer to Docket No. AD20-14-000, and must include the commenter’s name, the organization they represent, if applicable, and their address in their comments.

17. The Commission encourages comments to be filed electronically via the eFiling link on the Commission’s website at http://www.ferc.gov. The Commission accepts most standard word processing formats. Documents created electronically using word processing software should be filed in native applications or print-to-PDF format and not in a scanned format. Commenters filing electronically do not need to make a paper filing.

18. Commenters that are not able to file comments electronically must send an original of their comments to: Federal Energy Regulatory Commission, Secretary of the Commission, 888 First Street NE, Washington, DC 20426.

19. All comments will be placed in the Commission’s public files and may be viewed, printed, or downloaded remotely as described in the Document Availability section below. Commenters on this proposal are not required to serve copies of their comments on other commenters.

IV. Document Availability

20. User assistance is available for eLibrary and the Commission’s website during normal business hours from the Commission’s Online Support at (202) 502-6652 (toll free at 1-866-208-3676) or email at ferconlinesupport@ferc.gov, or the Public
Reference Room at (202) 502-8371, TTY (202) 502-8659. E-mail the Public Reference Room at public.referenceroom@ferc.gov.

21. The Commission provides all interested persons an opportunity to view and/or print the contents of this document via the Internet through the Commission’s Home Page (http://www.ferc.gov). At this time, the Commission has suspended access to the Commission’s Public Reference Room, due to the proclamation declaring a National Emergency concerning the Novel Coronavirus Disease (COVID-19), issued by the President on March 13, 2020.

22. From the Commission’s Home Page on the Internet, this information is available on eLibrary. The full text of this document is available on eLibrary in PDF and Microsoft Word format for viewing, printing, and/or downloading. To access this document in eLibrary, type the docket number excluding the last three digits of this document in the docket number field.

23. User assistance is available for eLibrary and the Commission’s website during normal business hours from the Commission’s Online Support at (202) 502-6652 (toll free at 1-866-208-3676) or email at ferconlinesupport@ferc.gov, or the Public Reference Room at (202) 502-8371, TTY (202) 502-8659. E-mail the Public Reference Room at public.referenceroom@ferc.gov.

By direction of the Commission. Commissioner Danly is concurring in part and dissenting in part with a separate statement attached.


Kimberly D. Bose,
Secretary.
DANLY, Commissioner, concurring in part and dissenting in part:

1. The Commission issues a proposed policy statement today in this docket to “encourage” Regional Transmission Organizations (RTOs) and Independent System Operators (ISOs) to develop potential Federal Power Act section 205\(^1\) filings proposing market rules to accommodate state-determined carbon pricing programs.\(^2\) I dissent in part because I believe that the issuance of a policy statement on this subject—a wholly discretionary act—is unnecessary and unwise. I concur with that part of the policy statement noting that we have jurisdiction to entertain section 205 filings that seek to accommodate state carbon-pricing policies, which is a fundamental principle that cannot be doubted.

2. As to my concern that the Commission should not exercise its discretion to issue a policy statement, I expressed similar concerns in my recent dissent to Order No. 2222 requiring RTOs/ISOs to promulgate rules to accommodate distributed energy resource aggregators.\(^3\) There I questioned the Commission’s seizure of authority at the expense of the States and advocated that “[w]e should allow the RTOs and ISOs . . . to develop their own DER programs in the first instance.”\(^4\) “[T]hen the question of the Commission’s jurisdiction will be ripe.”\(^5\)

3. This policy statement does not mandate that RTOs/ISOs adopt carbon-pricing accommodation regimes. I agree that the Commission should not issue such a mandate.

4. Instead, the policy statement “encourages” RTO/ISO rule changes. Without seeing a proposal, the Commission predetermines that any such proposal will be within


\(^4\) *Id.* (Danly, Comm’r, dissenting at P 4).

\(^5\) *Id.*
the Commission’s jurisdiction and “would not in any way diminish state authority.”

That may well turn out to be true, but I would have waited until we had an actual 205 filing before us rather than pre-judging the issue based on unstated assumptions about how such programs might work. It is easy to imagine any number of RTO/ISO carbon-pricing proposals that would violate the Federal Power Act by impermissibly invading the authorities reserved to the States. This policy statement is not, as the majority’s order characterizes it “another example of the type of ‘program of cooperative federalism’ that the Court noted with approval in EPSA.”

There is no program. This is instead a non-binding, blanket dismissal of potential jurisdictional concerns.

5. As to the substance of the policy statement, I concur. I cannot do otherwise. The policy statement amounts to little more than a statement of fact: section 205 of the Federal Power Act has not been repealed and the Commission therefore has jurisdiction to entertain section 205 filings that seek to accommodate state carbon-pricing policies. Surely, that need not be stated. And to the extent the Commission feels the need to “clarify” the fact that we have the power to accept just and reasonable tariff revisions that are designed to include mandatory state charges in energy and capacity market offers, I am hard-pressed to identify a more settled area of Commission law.

For these reasons, I respectfully concur in part and dissent in part.

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James P. Danly
Commissioner

[FR Doc. 2020-23296 Filed: 10/20/2020 8:45 am; Publication Date: 10/21/2020]

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7 Id. P 13 (quoting FERC v. Elec. Power Supply Ass’n, 136 S. Ct. 760, 779-80 (2016)).