WHAT'S HOT AT FERC?

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WHAT'S HOT AT FERC?

- FERC / State Jurisdiction
  - FERC authority over Demand Response affirmed
  - State authority to incent generation development rejected
  - State authority to authorize affiliate transactions pursuant to FERC waiver rejected
- CFTC Proposes to Permit Third-Party Actions for RTO Activities
- FERC ALJ Initial Decisions Threaten Mobile-Sierra

FERC / STATE JURISDICTION: DEMAND RESPONSE

Demand Response (DR) FERC Order No. 745

- DR: pays consumers for commitments to curtail their use of power, in order to curb wholesale rates and prevent grid breakdowns.
- FERC has permitted demand-side resources to participate in wholesale markets for over a decade.
- ISOs/RTOs could accept bids from aggregators of retail customers into wholesale energy markets.
- FERC Order No. 745 requires RTO/ISOs to compensate DR resources at the market price for energy.

FERC / STATE JURISDICTION: DEMAND RESPONSE

Challenges to FERC DR Authority at D.C. Circuit

- Industry Arguments
  - FPA gives FERC authority to regulate the sale of electricity at wholesale in interstate commerce.
  - Explicitly reserves regulation of retail rates to States.
  - DR is a function of retail market.
- FERC Response
  - DR aggregators voluntarily participate in wholesale markets (because of incentive of compensation at LMP), so they fall within FERC authority to make rules for market.
  - DR "directly affects" wholesale rates, even though DR is not a wholesale sale of electricity; DR participants are "direct participants" in wholesale markets.

FERC / STATE JURISDICTION: DEMAND RESPONSE

DC Circuit Rejected FERC DR Authority in EPSA v. FERC (2014)

- Court agreed that DR directly affects the wholesale market, but if "directly affects" is the standard, FERC could regulate any market that affects wholesale rates.
- "No limiting principle" under FERC's justification.
- DR is "part of the retail market. It involves retail customers, their decision whether to purchase at retail, and the levels of retail consumption."
- Clear prohibition on FERC regulating retail market, so FERC cannot require wholesale markets to compensate DR resources in the same way as generating resources.
- FERC cannot create jurisdiction by "luring" DR resource to enter wholesale markets.

FERC / STATE JURISDICTION: DEMAND RESPONSE

Supreme Court Affirmed FERC DR Authority (Jan. 2016)

- Court overturned DC Circuit, holding
- FERC's authority is limited to rules or practices that "directly affect" the wholesale rate.
- Order No. 745 meets that standard – DR bids in wholesale markets that set wholesale prices; DR bids accepted only if they bring down wholesale price; easing of pressure on grid brings down wholesale prices.
- "Wholesale demand response is all about reducing wholesale rates; so, too, then, the rules and practices that determine how these programs operate."
- Does not intrude on state jurisdiction just because it affects retail rates.

FERC / STATE JURISDICTION: DEMAND RESPONSE

FERC Rejected PJM Market Monitor Complaint Regarding Demand Response Provisions (EL14-20)

- PJM Independent Market Monitor filed complaint alleging
  - PJM's capacity market rules fail to treat DR resources equal to generation; and
  - DR resource should be subject to a must-offer requirement & an offer cap on all energy offers.
- FERC found that "comparability does not require identical application to demand response resources and generation resources of PJM's offer cap and the must-offer requirement."
- Consistent with Order No. 745?

FERC / STATE JURISDICTION: CAPACITY INCENTIVES

Maryland Power Plant Incentives

- Maryland accepted CPV proposal for construction of gas-fired power plant after concern that PJM capacity auction failing to bring new in-state generation.
  - CPV Maryland would sell capacity in PJM; if CPV did not clear a certain price, LSEs would cover the difference – an effective subsidy ("contract for differences").
- Incumbent generators challenged program as violation of Supremacy Clause / intrusion on FERC jurisdiction in federal District Court.
  - District court held that program intruded on FERC authority to set wholesale rates; Fourth Circuit affirmed.

FERC / STATE JURISDICTION: CAPACITY INCENTIVES

Supreme Court Rejected Maryland Program in Hughes v. Talen Energy (April 2016)

- "FERC has approved the PJM capacity auction as the sole ratesetting mechanism for sales of capacity to PJM, and has deemed the clearing price per se just and reasonable. Doubting FERC's judgment, Maryland—through the contract for differences—requires CPV to participate in the PJM capacity auction, but guarantees CPV a rate distinct from the clearing price for its interstate sales of capacity to PJM. By adjusting an interstate wholesale rate, Maryland's program invades FERC's regulatory turf."
- Distinguished from "traditional" contracts for capacity because the "contract for differences operates within the auction."

FERC / STATE JURISDICTION: CAPACITY INCENTIVES

Court "Limited" its Holding in Hughes v. Talen Energy

- Court said that holding did not address "various other measures States might employ to encourage development of new or clean generation, including tax incentives, land grants, direct subsidies, construction of state-owned generation facilities, or re-regulation of the energy sector" —measures "untethered to a generator's wholesale market participation."

FERC / STATE JURISDICTION: AFFILIATE POWER SALES

FERC's Rule for Affiliate Power Sales

- FERC's affiliate power sales restrictions: no wholesale sale of electric energy or capacity may be made between a franchised public utility with captive customers and a market-regulated power sales affiliate without prior FERC authorization ("Edgar" rule).
- First Energy, AEP had received waiver of prior affiliate approval based on fact that Ohio is a retail choice state and did not have captive retail customers.
- Ohio regulators approved PPAs under which AEP and First Energy affiliates would purchase plants' output, sell into PJM.

FERC / STATE JURISDICTION: AFFILIATE POWER SALES

FERC Rescinded AEP, FirstEnergy Waivers (April 2016)

- FERC rejected Ohio-approved PPAs as presenting the potential for inappropriate transfer of benefits from "captive" customers to shareholders.
  - "FE Ohio Regulated Utilities' retail ratepayers are "captive" in that they have no choice as to payment of the non-bypassable generation-related charges incurred under the Affiliate PPA."
  - "Where, as here, circumstances demonstrate that a retail customer has no choice but to pay the costs of an affiliate transaction, they effectively are captive with respect to the transaction."
- AEP, FirstEnergy must now receive prior FERC approval FERC for affiliate sales.

FERC / STATE JURISDICTION: AFFILIATE POWER SALES

AEP & First Energy – Back to Regulated Utilities?

- FirstEnergy maintains that PPAs would pass FERC's criteria for affiliate contract and would benefit customers.
- AEP, First Energy may be going back to Ohio regulators, legislature to advocate for re-regulation.

FERC / STATE JURISDICTION: CONGRESSIONAL RESPONSE

Letter to FERC from House Committee on Energy & Commerce (June 10, 2016)

- Described organized wholesale markets that "underachieve" as "administrative constructs that are continuously 'tweaked' through the regulatory process."
- Referenced the Supreme Court's decisions in FERC v. EPSA and Hughes v. Talen Energy as "evidence [of] the notion that the electricity landscape is changing, with the potential to impact markets, blur jurisdictional boundaries, and prompt judicial intervention."
- "Given the evolution of the electricity sector and the attendant challenges and opportunities presented, we believe participants in the electricity sector, as well as consumers, may be better served by Congress—rather than the courts—taking a more comprehensive review on many of these issues."

THIRD-PARTY RIGHTS OF ACTION FOR RTO ACTIVITIES

Background: CFTC Exempted RTO Transactions from CEA

- In 2013, under a statutory provision targeted to avoiding duplicative regulation, the CFTC exempted RTOs from virtually all aspects of the Commodity Exchange Act.
- Among the exemptions was the ability of 3rd parties to bring claims in federal district court.
- The CFTC has recently proposed to reverse course and permit 3rd party claims.
- Comments are due June 15,2016.

THIRD-PARTY RIGHTS OF ACTION FOR RTO ACTIVITIES

Case Study: Aspire v. GDF Suez

- Hedge fund brought an action in US District Court against a participant in the Electric Reliability Council of Texas (ERCOT) RTO market.
- The RTO market participant was acting in accordance with RTO market design and pursuant to explicit Public Utility Commission of Texas (PUCT) authorization.
- Based on the CFTC RTO exemption, the District Court dismissed the complaint; Fifth Circuit affirmed.

THIRD-PARTY RIGHTS OF ACTION FOR RTO ACTIVITIES

What Is At Stake

- RTO members could be subject to claims for RTO actions that are fully compliant with FERC/PUCT regulation and supported by RTOs and market monitors.

- District courts, unfamiliar with RTOs, would render rulings based upon the private litigants' arguments.
  - Rulings in court could effectively overturn FERC/PUCT regulation.
  - RTO members, to avoid exposure, would prospectively alter behavior, thereby frustrating FERC/PUCT regulation even if district court case ultimately fails .
- CFTC has not addressed whether RTO products are swaps. If a court so finds, FERC/PUCT could be divested of jurisdiction in favor CFTC "exclusive" jurisdiction.

MOBILE-SIERRA UNDER THREAT?

Summary

- The viability of the Mobile-Sierra presumption protecting the sanctity of negotiated market-based rate contracts is at serious risk.
- Topics:
  - What is the Mobile-Sierra presumption?
  - Recent initial decisions subverting Mobile-Sierra.
  - Trade association action.

MOBILE-SIERRA UNDER THREAT?

Mobile-Sierra Doctrine Established

- First established in 1954 Supreme Court cases.
- It holds that negotiated, fixed-rate contracts are to be presumed just and reasonable under the Federal Power Act (FPA) and cannot be revised by FERC without a finding that the public interest requires contract modification.
- In other words, some extraordinary need to intervene in a contract exists such that there will be a harm to society unless the government acts.

MOBILE-SIERRA UNDER THREAT?

Mobile-Sierra Doctrine Recently Affirmed

- Ninth Circuit: Pub. Util. Dist. No. 1 of Snohomish v. FERC (Dec. 19, 2006).
  - Held that Mobile-Sierra (just and reasonable) presumption applies only to contracts that FERC reviewed (at time of formation); found just and reasonable; and placed on file.
  - Even assuming Mobile-Sierra applied, when a purchaser challenges a contract, the standard for overcoming the presumption is a "zone of reasonableness" test.
  - Supreme Court REVERSED

MOBILE-SIERRA UNDER THREAT?

Mobile-Sierra Doctrine Recently Affirmed

- Supreme Court: Morgan Stanley (June 26, 2008).
  - Reversed the Ninth Circuit.
  - Upheld market-based rate application of Mobile-Sierra.
  - Generally found that the traditional Mobile-Sierra presumption applied.
  - Underscored the importance of contracts to the structure of the FPA.
  - Remanded the case for FERC to address two specified issues.

MOBILE-SIERRA UNDER THREAT?

Morgan Stanley

- As interpreted by Morgan Stanley, Mobile-Sierra requires that contracts be presumed just and reasonable and cannot be reformed unless:
  - the negotiation of the contract was directly affected by unlawful acts by a party, causing it to not be the product of fair, arms'-length negotiation; or
  - the contract causes such an excessive burden on consumer rates that there is an unequivocal public necessity that it be reformed.

MOBILE-SIERRA UNDER THREAT?

What the Supreme Court said about Mobile-Sierra

- Contract challenges must exceed a high bar, as "the regulatory system created by the [FPA] … contemplates abrogation of these agreements only in circumstances of unequivocal public necessity."
- "[E]nabling sophisticated parties who weathered market turmoil by entering long-term contracts to renounce those contracts once the storm has passed, … would reduce the incentive to conclude such contracts …. Such a rule has no support in our case law and plainly undermines the role of contracts in the FPA's statutory scheme."
- "We emphasize that the mere fact of a party's engaging in unlawful activity in the spot market does not deprive its forward contracts of the benefit of the Mobile-Sierra presumption."

MOBILE-SIERRA UNDER THREAT?

What the Commission has said about Mobile-Sierra

- To avoid Mobile-Sierra, a party must identify specific transactions and show that a seller's unlawful behavior directly affected a contract rate.
- To overcome Mobile-Sierra a party must make a "contract-specific" showing that a contract rate "seriously harms the public interest."
- "[C]laims of uniformly higher prices amount to little more than a variation on claims of general market dysfunction, which have been previously rejected by the Supreme Court as a basis for overcoming Mobile-Sierra."
- "The Mobile-Sierra inquiry is not about whether market dysfunction exists that would provide opportunities for unlawful activity, but whether a specific seller actually did engage in unlawful activity that directly affected a contract rate."

MOBILE-SIERRA UNDER THREAT?

Pacific Northwest Case (Puget Sound) Initial Decision

- Case related to contracts in the Pacific Northwest during the CA Energy Crisis.
- ID found Mobile-Sierra overcome w/o considering specific contracts/negotiation.
  - Ignored facts regarding how contracts are formed under the WSSP Agreement.
  - Relied on a "Power Markets Week + $75 screen" test to identify sales of energy at prices that were "too high" and in "bad faith."
  - Found a contract that exceeds pricing screen during emergency condition per se loses Mobile-Sierra presumption.
- Found that "high prices"= seller bad faith (without other findings of unlawful activity).
- Made other conclusory, non-contract-specific findings to avoid the Mobile-Sierra presumption.

MOBILE-SIERRA UNDER THREAT?

Long-Term Contract Case Initial Decision

- Addressed CDWR long-term contracts executed during the CA Energy Crisis.
- Mobile-Sierra presumption was overcome based on:
  - Finding of “public outrage”;
  - Finding that the Energy Crisis was “unprecedented”;
  - Finding that a consumer rate impact of $0.0-$0.08 per month on an average $75 bill is an excessive burden on consumers (citing Beethoven’s “Rage Over a Lost Penny”); and
  - Sua sponte finding of “fraud in the execution” under CA law – despite no claim pled or evidence of any actionable fraud affecting contract negotiations.
    - ALJ unilaterally created a cause of action and supporting “facts” (wrong on CA law and wrong on facts).

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Questions? Please Contact us.

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