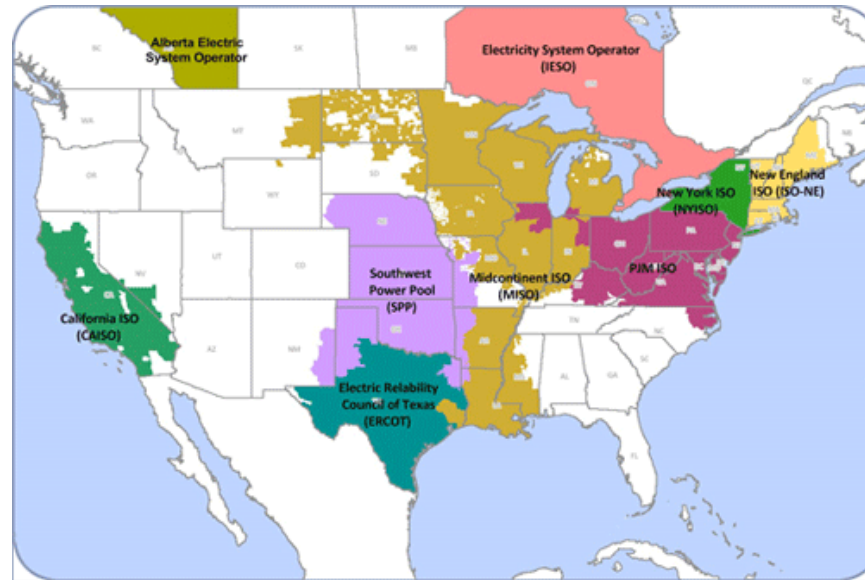
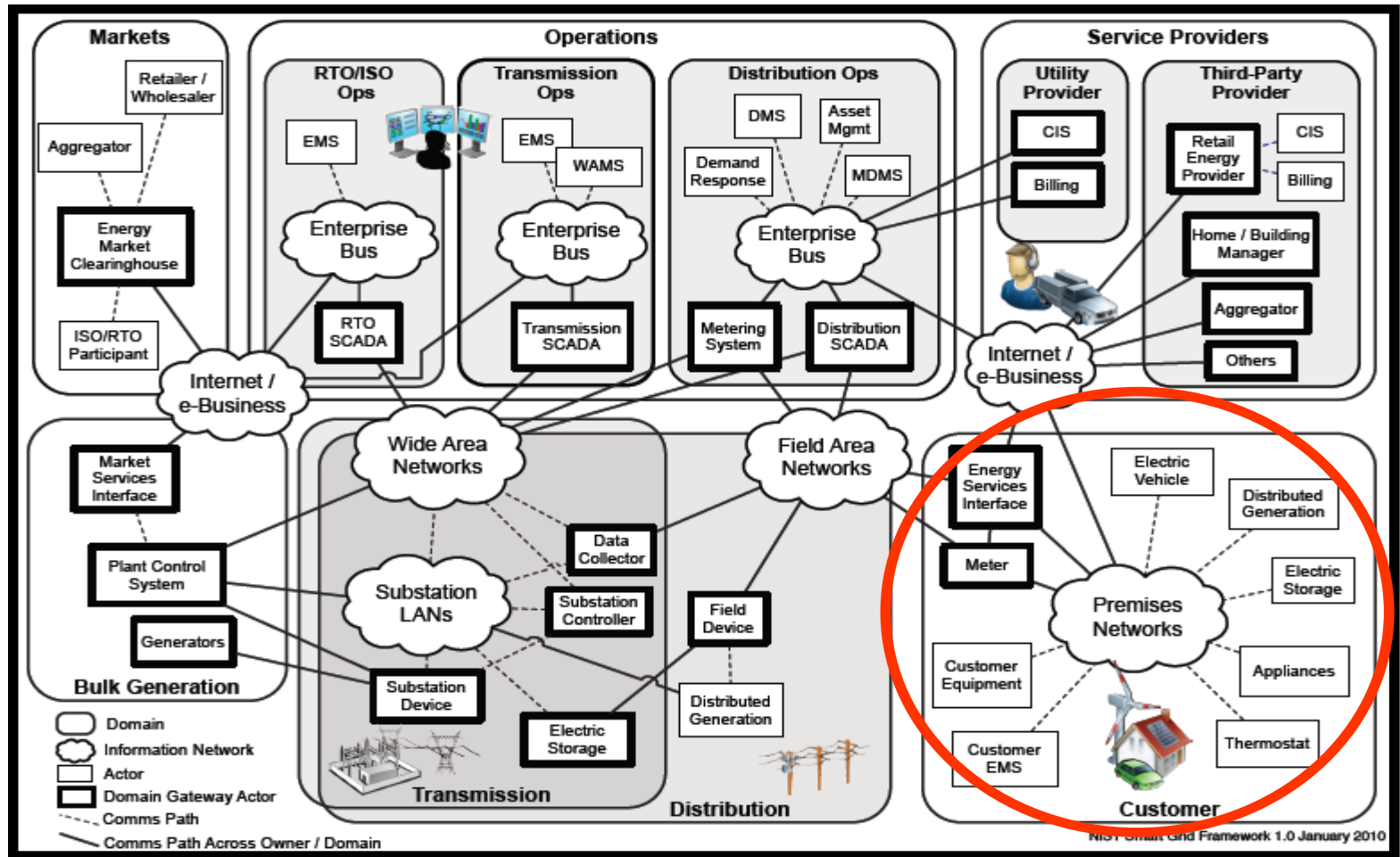


# FERC, Wholesale Markets, and the Smart Grid: Market Referee or Market Shaper?



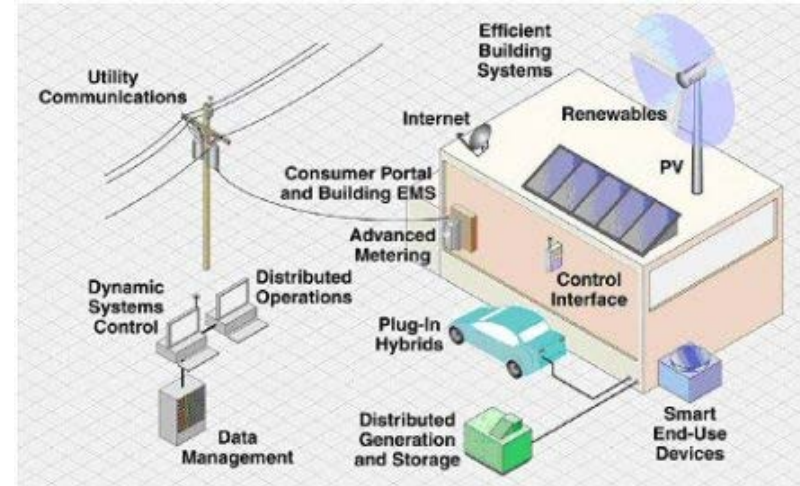
**Legal and Regulatory Issues,  
Obstacles and Opportunities in Electricity Markets**  
Third Annual Searle Center Conference on Energy Regulation  
Northwestern University Law School  
November 13, 2014  
Joel B. Eisen  
University of Richmond School of Law  
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# The Smart Grid



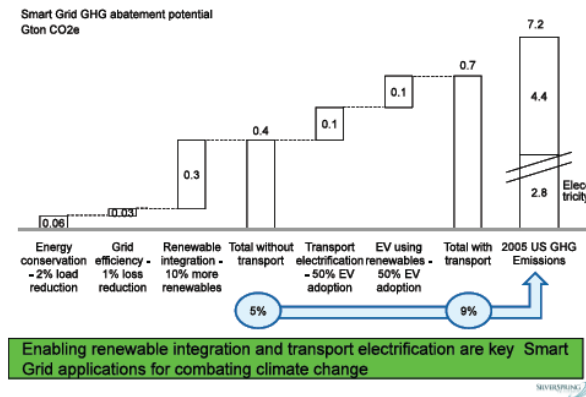
# Smart Grid Benefits

- Enhanced demand response
- Improved grid efficiency
- Distributed generation integration
- Electric vehicle integration
- Reduced GHG emissions



Source: Electric Power Research Institute

Smart Grid can enable the reduction of ~5-9% of 2005 GHG emissions



## Smart Appliances - 1

**Embedded Demand Response Strategies**

- Delay operation, defrost cycle
- Modify peak run time
- Reduced Peak features
- Low Power mode
- Temperature shift
- Listen for price / event signals

# FERC Authority & the Smart Grid

- Use of authority under the Federal Power Act to promote broad goals (integrate renewables and DR, promote innovation)?
- One touchstone in high-profile cases is FPA 206 “practice . . . affecting such rate” authority
- Instead of questions of *Chevron* deference, look to interpretations of “practice” in cases and historical context
- Develop factors supporting regulation
- Analogy to Commerce Clause justification of ACA individual purchase mandate



# FERC Authority: FPA Section 206

- “Whenever the Commission, after a hearing held upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that **any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential**, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order.”

**To regulate a practice affecting rates pursuant to Section 206, FERC must find that the existing practice is “unjust, unreasonable, unduly discriminatory or preferential”**

# Cases Interpreting FPA 206/NGA 5(a)

- **Electric Power Supply Association v. FERC** (D.C. Circuit panel vacates FERC Order 745/demand response)
- **South Carolina Public Service Authority v. FERC** (D.C. Circuit panel upholds FERC Order 1000/transmission planning and cost allocation)
- **ONEOK v. Learjet**, pending in SCT (Natural Gas Act regulation vs. state antitrust regulation of manipulation of natural gas market)

# Capacity Market Cases

- **Connecticut DPUC v. FERC**, 569 F.3d 477 (D.C. Cir. 2009): ISO-NE's "Installed Capacity Requirements" (determinations of minimum amount of capacity required in region) upheld against challenge that it is "direct regulation of generation facilities" prohibited by FPA 201
- **PPL Energyplus v. Solomon** (3<sup>rd</sup> Cir., Sept. 11, 2014): NJ statute (LCAPP) designed to promote construction of new capacity in state; "Standard Offer Capacity Agreements" held preempted by PJM RPM/BRA process for securing new capacity

# FERC Authority Over “Practices”

- Plain language of FPA = FERC regulation of markets meant to affect more than rates paid to sellers by buyers of electricity.
- FPA 205 and 206 speak to sellers; FERC has exclusive authority over rates, terms and conditions of wholesale “sales” but not over “purchases” (state jurisdiction) or “retail” sales
- YET: “affecting such rate”: FERC may reach activities that it does not directly regulate if it can connect them to jurisdictional sales
- Matters other than actual rates: FPA has never been construed to require that electricity be produced and sold at the lowest possible price



# "Practice" in the History of Federal Regulation

- Recurring inquiries to determine limits of regulatory agencies' jurisdiction
- NOT "elephant in mouse hole" (agency using obscure authority)
- "Section 206 cannot be fairly viewed as the type of 'subtle device' at issue in *MCI Telecommunications Corp. v. AT&T*" (*SCPSA*)

**It is highly unlikely that Congress would leave the determination of whether an industry will be entirely, or even substantially, rate-regulated to agency discretion-and even more unlikely that it would achieve that through such a subtle device as permission to "modify" rate-filing requirements. – *MCI Telecomm. Corp. v. Am. Tel. & Telegraph Co.*, 512 U.S. 218, 231 (1994).**

# History – Interstate Commerce Act

- FPA 206 modeled after IC Act § 15 (repealed)
- If ICC found "that any individual or joint classifications, regulations, or **practices** whatsoever of such carrier or carriers subject to the provisions" of the act are "unjust or unreasonable or unjustly discriminatory, or unduly preferential or prejudicial or otherwise in violation of any of the provisions of" the act . . .
- It could determine and prescribe just and reasonable rate or rates and "what individual or joint classification, regulation, or practice is just, fair, and reasonable," . . .

# U.S. v. Penn. Railroad Co. (1916) ("Tank Car Case")

- Tank cars = bottleneck = Rockefeller aimed to dominate industry by controlling shipping.
- Refiner/sellers wanted ICC to force RR's to make oil tank cars available; alternative = barrels @ 3.5-3.75 ¢/gal. > cost of transport in tank cars
  - RR refusal to supply tank cars would tend to drive refiners without them out of business
- Q: Did ICC have power to "require carriers to provide and furnish oil tank cars, no question of discrimination being involved"? (emphasis mine)



# "Tank Car Case"

- Supreme Court: NO obligation to provide tank cars = "practice" would have no limit as a result.
- Cited in contemporary cases BUT SCT distinguishes undue discrimination cases : "And there were many such acts for which the word could provide — practices which confused the relation of shippers and carriers, burdened transportation, favored the large shipper and oppressed the small one. These have illustrations in decisions of the Commission."
- RR's had a small fraction of total cars ("private cars" far more common) = Court claimed RR's powerless to affect, but could it have found undue discrimination in rates due to scarcity??





# Connecting History To The Present: Concerns In Contemporary Cases

- **Attenuation:** “practice” might lead to regulation of “non-market” conduct/no boundaries if accept agency’s interpretation
- **Insularity:** “practice” might involve regulation of non-market business practices
- **Preemption:** agency is overreaching/must stick to its regulatory sphere/cannot trump state law
- **How does history of interpreting “practices” inform current courts’ concerns?**
- **Compare to Commerce Clause cases probing limits of “mandates” (*NFIB v. Sebelius*)**

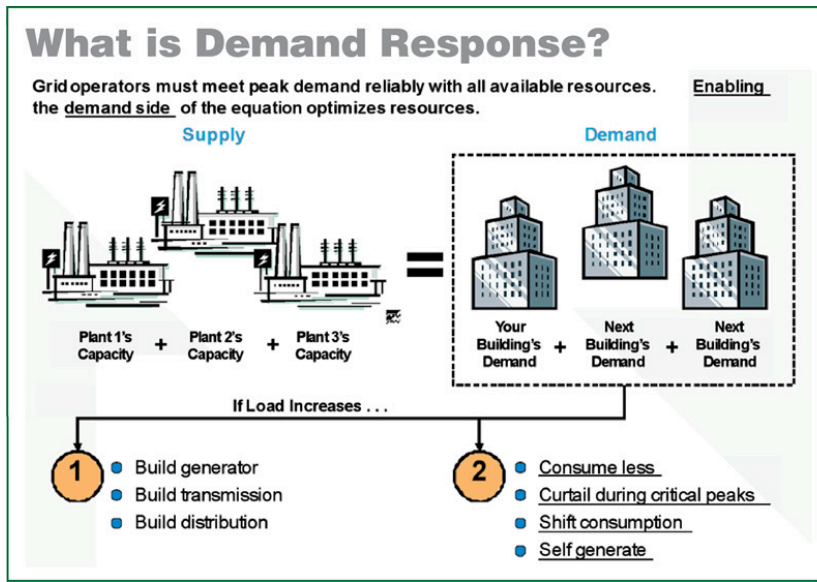
# Factor #1: Attenuation

- **“Non-connectedness”:** FERC regulation has no stopping point/impacts firms not within its jurisdiction
  - Purported lack of connection to wholesale markets; without limits = parade of horrors
  - *EPSA v. FERC*: “Without boundaries, § § 205 and 206 could ostensibly authorize FERC to regulate any number of areas, including the steel, fuel, and labor markets.”
  - *AGA v. FERC* (D.C. Cir. 1990, barring FERC jurisdiction under NGA sec. 5(a) over TOP contracts): if no limits, FERC could regulate “every other possible factor of production-including legal services”
- **What connection has sufficient direct effect on markets?**



# Factor #1: Attenuation

- **Regulate direct participants' direct actions in wholesale markets; proceed with caution with other firms**
- "DR by definition alters the wholesale electricity price. That is about as 'direct' an effect and as clear a 'nexus' with the wholesale transaction as can be imagined" (*EPSA v. FERC* dissent)



**DR aggregators ≠ generators; however, they are direct market participants**

# Factor #2: Insularity

- **FERC cannot regulate participants' "internal practices"**
- Concern: some firm behavior/judgments have no external impact, FERC can't regulate them
- *EPSA v. FERC (citing CAISO)*: "FERC exceeded its jurisdiction when it replaced the board members of an ISO on the theory that the composition of the ISO's board was a 'practice' . . . affecting a rate"

**Why too much of a "leap" in jurisdiction? (looks like "regulating the employee handbook" = no external impact)**





# Factor #2: Insularity

- **Identify “those methods or ways of doing things on the part of the utility that directly affect the rate or are closely related to the rate**, not all those remote things beyond the rate structure that might in some sense indirectly or ultimately do so” (*EPSA* dissent)
- “Reforming the practices of failing to engage in regional T planning and . . . cost allocation . . . is not the kind of interpretive ‘leap’ that concerned the court in *CAISO*” (*SCPSA*)
  - *TAPS* (D.C. Cir. open access/Order 888 decision): failure to act (deny use of T lines) can be a practice
- Still need guidance re “directly affect” << history



# Factor #3: Preemptive Effect

- **FERC cannot regulate matters left to states**
- *EPSA v. FERC*: “FERC can regulate practices affecting the wholesale market under § § 205 and 206, provided the Commission is not directly regulating a matter subject to state control, such as the retail market”
- **How evaluate decisions w/impacts on both jurisdictional & non-jurisdictional spheres?**
  - DR = both “non-consumption” (affects retail rate) and resource offered in wholesale markets (jurisdictional)
  - *Conway*: FERC can regulate a jurisdictional sale even if has some non-jurisdictional impacts = FERC can’t set retail rates but can impact them



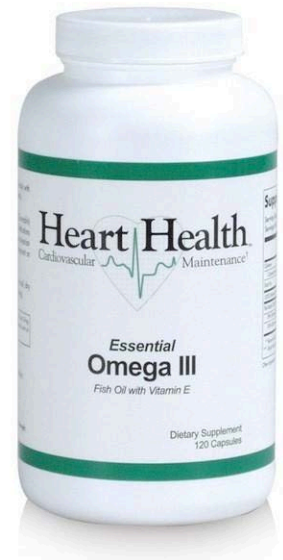
# Factor #3: Preemptive Effect

- Look to preemption doctrine/states' remaining regulatory scheme & flexibility
- Does FERC decision preempt state authority? Look to whether state keeps authority in traditional spheres **even if modified by federal decision?** >> in transmission, DR, capacity cases, much regulatory room left
  - States retain approval over transmission line siting and construction (*SCPSA*)
  - States can regulate DR (e.g., license aggregators); Order 745 only reaches level of compensation (*EPSA* dissent)
  - Capacity market cases: *PPL Energyplus v. Solomon*, 3<sup>rd</sup> Cir. = field preemption of capacity decisions BUT “states may select the type of generation to be built—wind or solar, gas or coal—and where to build the facility”



# Factor #4: Structural Oversight

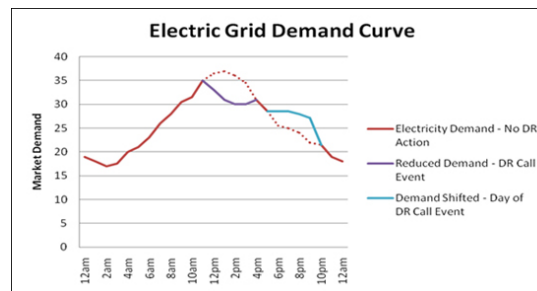
- **FERC may regulate to address overall market structure and functioning**
- “FERC has the authority to review the justness and reasonableness of rates that are so closely connected with the healthy functioning of its jurisdictional markets” (*EPSCA* dissent)
- Cases term this “heartland of 206 jurisdiction” w/deference to FERC “at its zenith”
- **What impact must FERC decision have on the wholesale markets?**





# Factor #4: Structural Oversight

- **FERC may regulate if actions have “direct system-wide implications that affect rates and other jurisdictional matters”**
- Transmission planning = benefits of regional planning vs. single-system planning accrue to region as a whole
  - T planning unquestionably = “practice” (*SCPSA*)
- DR has impact on jurisdictional rates by altering wholesale electricity prices & providing a resource in capacity markets (>10 GW in PJM BRA); reliability impacts



# Analogy to ACA Mandate

- Orders 1000/745 are “mandates” = compare Commerce Clause jurisprudence & recent search for limits (*NFIB v. Sebelius*)
- All four concerns involve similar challenges: e.g., defining “mandate” as function of remoteness from market for insurance >> “broccoli purchase” requirement
- Also: “mandate” thought to have no limit = search for precision re dividing line
- Focuses on firms’ behavior rather than interpreting difficult retail/wholesale line



# ONEOK v. Learjet (*pending in SCT*)

- Case centers on claims that natural gas traders manipulated market in 2000-2002 energy crisis
- 9<sup>th</sup> Cir. = NGA Section 5(a) "practice" jurisdiction does **NOT** preempt state antitrust claims
- Cites *CAISO* & *AGA*: "Under the broad reading of Section 5(a) that Defendants propose, there is no "conceptual core" delineating transactions falling within FERC's jurisdiction and transactions outside of FERC's jurisdiction."

# ONEOK v. Learjet

- Decision reversing Ninth Circuit may support broad reading of “practice” jurisdiction, particularly in mixed jurisdictional context.
- EPSA amicus brief = position opposite from *EPSA v. FERC*:
  - “Ninth Circuit confronted a practice (alleged manipulation of natural gas price indices) that is ‘associated with’ both jurisdictional and non-jurisdictional sales.”
  - “[Its] holding turns established federal preemption doctrine on its head and threatens to substantially disrupt the wholesale energy industry.”
- SCT may articulate the “conceptual core” of “practice” jurisprudence
- However, FERC is **NOT** a party so uncertainty re impacts on FPA 206 cases