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Supreme Court's Defense of FERC Jurisdiction Leaves Questions for States

Service

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For the second time this year, the U.S. Supreme Court has defended the jurisdiction of the Federal Energy Regulatory Commission (FERC) to regulate interstate wholesale energy rates. In *Hughes v. Talen Energy Marketing*, handed down April 19, 2016, the Court held that a state of Maryland incentive program designed to encourage construction of new in-state power plants unlawfully invaded FERC’s exclusive jurisdiction over wholesale electricity rates. However, the Court’s overt intention to narrowly affirm the lower court’s holding may be as notable as the decision itself, in that it leaves open other means by which states can pursue legitimate goals.

The Challenge

As the Court reiterates in an 8-0 opinion, the Federal Power Act assigns jurisdiction over interstate wholesale power sales to FERC and reserves regulation of retail electric markets to the states. Functionally, FERC exercises its authority to ensure just and reasonable wholesale power rates in one of two ways: (1) review of bilateral contracts between load serving entities (LSEs) and power generators to ensure the contracts contain just and reasonable rates, or (2) regulation of the competitive wholesale auctions administered by regional transmission organizations (RTOs) and independent system operators.

In *Hughes v. Talen Energy Marketing*, the plaintiff, an incumbent generator, challenged Maryland’s new incentive program, asserting that it invaded FERC’s exclusive regulatory domain. The program required that in-state LSEs sign 20-year power purchase agreements (PPAs) with new in-state generators, which effectively guaranteed those generators a subsidized rate regardless of what the generators received in the FERC-regulated wholesale auction. Following such auction, the program contracts required either the LSE or the generator to make payments to the other party based on the difference between the agreed-upon contract rate and the regulated wholesale auction price. This requirement enabled the new generators to bid low into the auction, thereby artificially lowering the clearing price to all other generators. Even though these payments occurred after the wholesale auction process, the Court's decision focused primarily on its effect on FERC's authority, as well as Maryland's role in mandating LSE participation in the program.

Not-So-Incidental Effect

The Court acknowledged that the states may, through the course of exercising their regulatory powers, incidentally affect FERC's regulatory domain; however, the Court held that the structure of the program contracts had more than an incidental effect on FERC's authority. According to the Court, the compensation payments enabled program participants to disregard the wholesale auction clearing price, thereby hindering FERC's ability to control the regulated wholesale rate.

Notably, the plaintiffs also argued that Maryland's program threatened to disrupt FERC's ability to use the wholesale auction clearing price to read market signals for power supply and demand. But the Court declined to resolve whether this issue alone could be considered more than an incidental effect.

Coming on the heels of its January 2016 decision in *FERC v. Electric Power Supply Association* (for more information, read our previous alert), which held that FERC has authority over demand response payments that might affect retail loads regulated by states, the Hughes decision affirms FERC's broad authority to fashion interstate rules under the Federal Power Act in response to evolving market needs. But the Court was careful to note that this decision was program- and fact-specific and did not signal that other state efforts to encourage generation or ensure resource adequacy would necessarily be struck down. In fact, the Court seemed to go out of its way to point to the exact program details that caused the Maryland program's demise.

What This Means to You

While the Court's decision directly affects the Maryland program and a similar program in New Jersey, a broader question remains for how it will affect energy companies operating in other states. What does a state incentive program for power generators look like that does not invade FERC's jurisdictional authority?

The Court unfortunately does not provide states much direction. On one hand, the decision appears to call into question the traditional power of states to regulate state-jurisdictional utilities – if that power affects wholesale energy markets – and to address issues such as environmental harm. On the other hand, by emphasizing the particular flaws of Maryland's program, the decision creates a warning list of program elements to be avoided, perhaps enabling a carefully tailored state resource incentive program to succeed. That state program must not impede FERC's ability to effectively review the rates of the wholesale power being sold by the generators. The program should not force private actors in the market to enter into contractual agreements with one another. And the program should not condition its benefits on the generator clearing the wholesale auction.

Thus, the Court answers only a few questions while leaving industry participants asking several others. How broad are the powers of FERC under the Federal Power Act, and how should states judge whether an incentive program's effect on FERC's power is more than incidental? How would the Court have responded to the Dormant Commerce Clause argument raised by the respondents if the Court had found it relevant? How much does FERC's refusal to extend the New Entry Price Adjustment (NEPA) duration limit a state's ability to encourage long-term PPA agreements with rate guarantees? These are just a few of the questions the industry must analyze moving forward.

Contact Us

Husch Blackwell's Energy Regulation group provides a full range of legal services and guidance to clients subject to FERC, state public utility commissions and competitive wholesale electricity markets. For more information on state incentive programs or FERC jurisdiction, contact Linda Walsh at 202.378.2308, Kyle Barry at 217.572.1208 or James Hoecker at 202.378.2316.