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FEDERAL ENERGY UPDATE

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The following material provides a summary of recent developments in federal electric power and natural gas regulation. In the past year, the Supreme Court has decided an unprecedented batch of three FERC-related cases under the Federal Power Act (FPA) and the Natural Gas Act (NGA), an indication of active litigation in several appellate courts. Although not as substantial as the Energy Policy Acts of 2005 and 2007, energy-related bills have once again been actively pursued in the Congress. The Department of Energy (DOE), the Federal Energy Regulatory Commission (FERC), the Commodities and Futures Trading Commission (CFTC), and the Environmental Protection Agency (EPA) have all issued rules that seek either to modify company practices or behaviors or to promote new business models, markets, market entrants, or encourage infrastructure planning and increased resource development. On the whole, the last twelve months may serve as a prelude to fundamental changes in domestic energy production, delivery, and consumption in the coming decade.

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I. Supreme Court Trilogy of FERC Cases

A. Preemption: State Anti-Trust Law

The Supreme Court recently held that state antitrust claims are not preempted by the Natural Gas Act (NGA).[1] In *Oneok v. Learjet*, natural gas customers who purchased natural gas directly from interstate pipelines sued the pipelines, alleging that the pipelines had reported false information to the natural gas indices and engaged in behavior that violated state antitrust laws, causing the customers to overpay. The pipelines removed the claim to federal district court, arguing in a motion for summary judgment that the customer's state law antitrust claims were preempted by NGA Section 5(a).[2] The federal district court granted the motion for summary judgment, which the Ninth Circuit reversed.

In ruling against the pipelines, the Supreme Court reasoned that the NGA was drafted to preserve state power. The Court stated that state antitrust laws target practices that affect retail prices; retail prices are firmly in the state's jurisdiction. The Court affirmed the Ninth Circuit's reversal of summary judgment for the pipelines.

B. Preemption: Resource Adequacy

In *Hughes v. Talen Energy Marketing, LLC*, the Supreme Court held that a state regulatory program was preempted by the Federal Power Act (FPA).[3] Wholesale power generators sued the State of Maryland because its regulatory program authorized construction of a new power plant and required the plant to enter into a twenty-year pricing contract with PJM Interconnection. The state program guaranteed the generator's energy price. The wholesale generators argued that Maryland's program was preempted by the FPA.

In ruling for the wholesale generators, the Supreme Court reasoned that Maryland's program upset the division of authority between state and federal regulators that FPA Section 201 established. FPA Section 201 grants the FERC jurisdiction over rates for and affecting wholesale prices and it grants the states jurisdiction over retail sales. The Supreme Court stated that Congress intended for Federal law to grant exclusive authority over wholesale rates to FERC. It reasoned that Maryland's program was preempted because it disregarded the interstate wholesale rate required by FERC.

C. Jurisdiction: Demand Response

In *FERC v. Electric Power Supply Association*, the Supreme Court evaluated federal and state jurisdiction over wholesale demand response pricing and held that FERC has authority to

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[1] *Oneok v. Learjet*, 135 S. Ct. 1591 (2015).

[2] NGA Section 5(a) authorizes FERC to determine and fix just and reasonable rates that may be charged by companies who transport or sell natural gas.

[3] *Hughes v. Talen Energy Marketing, LLC*, 136 S. Ct. 1288 (2016).

regulate pricing of wholesale demand response service.[4] The Court stated, "The FPA delegates responsibility to FERC to regulate the interstate wholesale market for electricity–both wholesale rates and the panoply of rules and practices affecting them."[5] FERC's Order No. 745 established the rules and practices for demand response (DR).[6] Demand response involves programs that curtail power consumption by consumers in response to market operators, but FERC calculated demand response compensation at the wholesale level.[7] The Electric Power Supply Association sued FERC, asserting that Order No. 745 exceeded FERC's jurisdiction by infringing on the states' retail jurisdiction.

The Supreme Court reasoned that the Federal Power Act Section 201 grants FERC authority over wholesale electric sales, and the Federal Power Act Section 205 requires that all rates and charges in connection with wholesale sales – and the rules "affecting" wholesale rates and charges – must be just and reasonable. The Court determined that the rates and charges for demand response services affect wholesale rates. While transactions in the wholesale market have consequences for the retail market, the Court found that effect legally inconsequential. Additionally, the Court held that FERC was not arbitrary and capricious in selecting the demand response pricing model because FERC engaged in reasoned decision making when selecting the formula.

II. Appellate Court Developments

A. Electric Power Contract and Tariff Issues

1. Order No. 1000-Rights of First Refusal

Transmission owners and incumbents separately petitioned the D.C. Circuit and the Seventh Circuit to determine whether *Mobile-Sierra's* just and reasonable presumption[8] applied to the right of first refusal (ROFR) provision in Southwest Power Pool's (SPP) and Midcontinent Independent Service Operator's (MISO) RTO membership agreements.[9] In *MISO Transmission*

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[4] *FERC v. Elec. Power Supply Ass'n*, 136 S. Ct. 760 (2016).

[5] *Elec. Power Supply Ass'n*, 136 S. Ct. 760 (2016).

[6] *Demand Response Compensation in Organized Wholesale Energy Markets*, 135 FERC ¶ 61,187 (Mar. 15, 2011). FERC Order No. 719 required wholesale market operators to receive demand response bids from aggregators of electricity consumers, except when the state regulatory authority overseeing those users' retail purchases bars demand response participation.

[7] Order No. 745 established a locational marginal price (LMP) for DR and set forth a "net benefits" test. The LMP calculation compensated demand response providers the same amount for conserving energy as generators that would otherwise produce it.

[8] The core *Mobile-Sierra* doctrine provides that freely negotiated, rate-related contract terms for wholesale energy are presumed just and reasonable, and FERC cannot set aside the rate unless it is contrary to the public interest. *United Gas Pipeline Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956); *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956). The contract term must be the product of adversarial negotiations between sophisticated parties pursuing independent interests.

[9] *Oklahoma Gas & Electric Co. v. FERC*, Case No. 14-1281 (D.C. Cir. 2016); *MISO Transmission Owners v. FERC*, 819 F.3d 329 (7th Cir. 2016). FERC's Order No. 1000 removed incumbent utilities' ROFR. *Order*

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