Hearing Before the House Energy and Power Subcommittee on

Federal Power Act: Historical Perspectives

September 7, 2016

Testimony of

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Good morning Chairman Whitfield, Ranking Member Rush, and members of the Subcommittee. My name is Doug Smith. I am a partner at the firm of Van Ness Feldman, LLP, where I am the coordinator of the firm's electricity practice. I previously served as General Counsel at the Federal Energy Regulatory Commission from 1997 through 2001, and as Deputy General Counsel for Energy Policy as the Department of Energy before that. In this testimony, I present my personal views, not those of Van Ness Feldman or any of its clients.

Thank you for the invitation to speak with you about the history of the Federal Power Act and the division of electric sector regulatory jurisdiction between Federal and State regulators. Section I provides an overview of this history of Federal regulation of the electricity sector. Section II reviews the split of regulatory jurisdiction over electric utilities between Federal and State regulators, and how that relationship has changed over time. Section III flags some recent questions on the Federal-State split of regulatory authority.[1]

[1] I note that this written testimony is informed by research I have done with colleagues under contract to Lawrence Berkeley National Laboratory on the Federal/State jurisdictional split. The views expressed herein are my own.

I would commend to the Subcommittee two excellent articles as resources on these issues: Robert R. Nordhaus, "The Hazy 'Bright Line': Defining Federal and State Regulation of Today's Electric Grid," 36 Energy L. J. 203 (2015); and Jeffrey S. Dennis, "Twenty-Five Years of Electricity Law, Policy and Regulation: A Look Back," 25 Natural Resources & Env't 33 (2010).

I. Key Developments in the History of Electric Sector Regulation Under the Federal Power Act

In the early 1900s, states began comprehensively regulating the activities of electric utilities, including generation, transmission, distribution and sale of electricity.

In 1927, the Supreme Court found that the Constitution imposes limits on state regulation of electric utilities when it decided *Public Utilities Commission of Rhode Island v. Attleboro Steam & Electric Co.*[2] In that case, the Public Utilities Commission of Rhode Island sought to regulate the terms of a wholesale sale by a utility in Rhode Island to a utility in neighboring Massachusetts. The Court held that the dormant Commerce Clause barred Rhode Island from regulating interstate wholesale electricity sales, stating "such regulation . . . can only be attained by the exercise of the power vested in Congress."[3] Because at that time no such Federal regulation of the electricity sector existed, the Court's decision left a regulatory void that would come to be known as the "*Attleboro* gap." Congress had the authority to regulate interstate electricity sales under the Commerce Clause, but unless it acted, no federal agency existed to regulate interstate wholesale electric sales.

In 1935, Congress enacted the Federal Power Act (FPA) to fill the *Attleboro* gap.[4] Under Section 201(b) of the FPA, the Federal Power Commission (FPC), the predecessor to the Federal Energy Regulatory Commission (FERC),[5] was granted the authority to regulate "the transmission of electric energy in interstate commerce and . . . the sale of electric energy at wholesale in

[2] 273 U.S. 83 (1927) (*Attleboro*).
[3] *Attleboro*, 273 U.S. at 90.
[4] 16 U.S.C. §§ 791a-825r (2012 & Supp. II 2014).
[5] Created in 1920, the FPC was originally composed of three cabinet secretaries – the Secretary of the Interior, the Secretary of War and the Secretary of Agriculture – charged with administering the Federal Water Power Act. In 1930, Congress amended the law to establish the FPC as an independent, five-person, bipartisan commission. In the 1977 DOE Organization Act, the FERC was established as a successor to the FPC, as an independent agency within the Department of Energy. Department of Energy Organization Act, Pub. L. No. 95-91, §§ 204, 402; 91 Stat. 565, 571-72, 583-585 (1977) (codified as 42 U.S.C. §§ 7134, 7172 and 16 U.S.C. §§ 792, 824, 824a).

interstate commerce."[6] The core provisions of the Act provide for public utilities to file "rates and charges for any transmission or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services."[7] Such rates must be just and reasonable, and may not be unduly discriminatory or preferential.[8] The Commission's cost-of-service ratemaking, and subsequent authorization of market-based rates and requirements for open access transmission, were all founded on these broadly stated statutory standards enacted in 1935.

Part II of the FPA enacted in 1935 contains a number of other provisions which address other aspects of electric utility regulation, including requirements for approval of certain stock or debt issuances by a public utility,[9] requirements for approval of certain mergers, acquisitions or other corporate transactions,[10] and emergency authorities.[11]

For a number of decades after enactment of Part II, the electric sector regulated under the FPA, was characterized by vertically integrated electric utilities operating as monopoly service providers within state-designated service territories. The Commission's principal function with respect to electricity regulation was applying cost-of-service rate principles in reviewing rates for wholesale sales, that is, sales by a public utility to another utility. Most of the activities of the public utilities related to providing bundled retail service to end-use customers, which was subject to state, not Federal, regulation.

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[6] 16 U.S.C. § 824(b)(1).
[7] 16 U.S.C. § 824d(c).
[8] 16 U.S.C. §§ 824d(a), (b), 824e(a). Section 205 governs the filing of rates and rate changes by the public utility. 16 U.S.C. § 824d. Section 206 governs changes to utility rates sought by the Commission or third parties. 16 U.S.C. § 824e. The substantive standards – just and reasonable, and no undue discrimination or preference – are the same under the two sections.
[9] 16 U.S.C. § 824c.
[10] 16 U.S.C. § 824b.
[11] 16 U.S.C. § 824a (as amended by Pub. L. No. 114-94, § 61002(a) (2015)).

The industry and the regulatory structure both began to change in the late 1970s, when Congress enacted the Public Utility Regulatory Policies Act (PURPA). PURPA was part of an energy legislative package that also included the Natural Gas Policy Act and the Fuel Use Act, and was driven by concerns about oil and natural gas shortages. PURPA included provisions that enabled non-utilities to own and operate certain cogeneration and renewable generation facilities, by requiring utilities to purchase the output of such plants.[12] This led to the first substantial influx of non-utility generators.

The Energy Policy Act of 1992 further opened the door to independent power producers by amending the FPA to authorize FERC to order transmission-owning utilities to provide wheeling services to other participants in the wholesale market,[13] and by reforming the Public Utility Holding Company Act to remove regulatory obstacles to the development and ownership of generators by independent power producers.[14] These changes were intended to support more competition in wholesale markets.

The next big electric regulatory reforms were undertaken by FERC. In the late 1980s, FERC began authorizing wholesale sellers to make sales at market-based rates, as opposed to the traditional cost-of-service rates, if the seller could demonstrate that it did not have market power.[15] In 1996, FERC issued Order No. 888, a rule that required all public utility transmission owners to unbundle transmission service from wholesale sales, and to provide transmission service to any party requesting it under the terms of an Open Access Transmission Tariff.[16] The

[12] 16 U.S.C. § 824a-3.
[13] 16 U.S.C. §§ 824j, 824k.
[14] Energy Policy Act of 1992, Pub. L. No. 102-486 § 711, 106 Stat. 2776, 2905 (1992).
[15] *See, e.g.*, *Heartland Energy Services, Inc*., 68 FERC ¶ 61,223 (1994) (reviewing early FERC decisions granting requests for market-based rate authority).
[16] *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Servs. by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, 61 Fed. Reg. 21,540 (May 10, 1996), FERC Stats. & Regs. ¶ 31,036 (1996), *order on reh'g*, Order No. 888-A, 62 Fed. Reg. 12,274 (Mar. 14, 1997), FERC Stats. & Regs. ¶ 31,048 (1997), *order on reh'g*, 81 FERC ¶ 61,248 (1997), *order on*

legal foundation for this rule was the FPA Section 206 authority to remedy undue discrimination – FERC found that open access transmission service was necessary prevent transmission-owning utilities from favoring their own wholesale sales relative to third-party sales in their provision of transmission service. In 1999, FERC issued Order No. 2000 which sought to drive the development of regional transmission organizations (RTOs) to provide for regional operation of the transmission grid.[17] All of these changes – authorizing market-based rates, providing for transmission open access, and encouraging the regional operation of the transmission grid – supported the development of more competitive wholesale power markets.[18]

In parallel with the reforms moving toward wholesale electricity market competition described above, a number of states were introducing competition into the provision of retail electric service in the late 1990s. California was a leader, and a number of states, particularly states with relatively high retail rates, pursued a similar course. As part of this movement, a number of states also directed the utilities they oversaw to restructure – typically by divesting most or all of their generation assets and relying instead on purchases from the competitive wholesale market for electricity supply to serve retail load. The movement among states toward retail competition largely came to a halt in the wake of the California electricity crisis in 2000-2001.

Congress made further amendments to the FPA in the Energy Policy Act of 2005. A number of changes were made in direct response to perceived gaps in FERC's authority to

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reh'g, 82 FERC ¶ 61,046 (1998), *aff'd in relevant part sub nom. Transmission Access Policy Study Grp. v. FERC*, 225 F.3d 667 (D.C. Cir. 2000), *aff'd sub nom. New York v. FERC*, 535 U.S. 1 (2002).

[17] *Regional Transmission Organizations*, Order No. 2000, 65 Fed. Reg. 809 (Jan. 6, 2000), FERC Stats. & Regs. ¶ 31,089 (1999), *order on reh'g*, Order No. 2000-A, 65 Fed. Reg. 12,088 (Mar. 8, 2000), FERC Stats. & Regs. ¶ 31,092 (2000), *aff'd sub nom. Pub. Util. Dist. No. 1 of Snohomish County, Washington v. FERC*, 272 F.3d 607, 348 U.S. App. D.C. 205 (D.C. Cir. 2001).

[18] The movement toward allowing market-based rates for wholesale sales, requiring open access transmission, and unbundling of transmission and energy sales had strong parallels to Congressional and FERC reforms in the natural gas sector in the 1980s and 1990s.

regulate new competitive markets. For instance, an express prohibition on market manipulation was added to the Act,[19] and FERC's civil penalty authority was increased from $5000 to $1,000,000 per violation.[20] Congress also authorized mandatory reliability regulation, and took several steps intended to promote transmission infrastructure investment.

Although there have been a number of amendments to Part II of the FPA since its enactment in 1935, the core authorities concerning regulation of public utilities providing transmission service in interstate commerce and making wholesale sales in interstate commerce, applying the just and reasonable standard and barring undue discrimination or preference, remain unchanged. It is these authorities, contained in sections 205 and 206 of the Act, which have been the basis for the Commission's landmark rulemakings on issues such as transmission open access, RTO development, and regional transmission planning and cost allocation. Likewise, FERC was applied these authorities as it transitioned from universal cost-of-service regulation to a regulatory construct emphasizing market-based rates and competitive market principles, with a related focus on policing of market power and market manipulation, for the great bulk of wholesale power sales.

II. Division of Electric Industry Regulatory Jurisdiction Between Federal and State Governments

A. Federal Power Act Specifications of Federal Jurisdiction

As noted above, regulation of electric utilities began at the State and local level. However, in 1927, the Supreme Court significantly constrained state regulation when it decided in *Attleboro* that dormant Commerce Clause principles barred Rhode Island from regulating

[19] 16 U.S.C. § 824v.
[20] 16 U.S.C. § 825o.

interstate wholesale electricity sales, leaving a regulatory void that would come to be known as the "*Attleboro* gap."[21]

In 1935, Congress enacted the Federal Power Act to fill the *Attleboro* gap. Under Section 201(b)(1) of the FPA, the FPC was granted the authority to regulate "the transmission of electric energy in interstate commerce and . . . the sale of electric energy at wholesale in interstate commerce."[22] That same section, however, specifically excluded from FERC's jurisdiction: (1) *retail sales* of electricity; (2) facilities used for the *generation* of electricity; and (3) facilities used for *local distribution* of electricity.[23] Section 201 also states that "Federal regulation . . . extend[s] only to those matters which are not subject to regulation by the states."[24]

In addition to the express reservations of jurisdiction over generation, local distribution and retail sales to the States, Section 201 contains two other important limitations on FPA jurisdiction. First, it limits Federal regulatory authority to transmission and wholesale sales *in interstate commerce*. Applying a commingling test, the courts have read "in interstate commerce" broadly. Thus, as a practical matter, this "in interstate commerce" requirement excludes only activity in Alaska, Hawaii, and the ERCOT portion of the Texas grid (because ERCOT is a separate, single-state interconnection).

Second, the core requirements of the FPA apply only to public utilities. Public utilities are entities that own or operate jurisdictional transmission facilities or have jurisdictional "paper facilities" such as wholesale contracts or tariffs, but expressly excludes government-owned utilities and certain cooperatively owned utilities.[25] So investor-owned utilities and investor-owned independent power producers and marketers are public utilities, but Federal utilities (*e.g.*,

[21] *Attleboro*, 273 U.S. at 90.
[22] 16 U.S.C. § 824(b)(1).
[23] 16 U.S.C. § 824(b)(1).
[24] 16 U.S.C. § 824(a).
[25] 16 U.S.C. § 824(f).

TVA and BPA), municipal utilities, public utility districts, and most electric cooperatives are not public utilities subject to full FPA rate and corporate transaction regulation.

B. Court Precedent Addressing FPA § 201 Jurisdiction Questions

The courts have wrestled with defining and applying the jurisdictional line drawn in Section 201 of the FPA from the beginning. It is worth noting that, while the *Attleboro* case was decided on dormant Commerce Clause grounds, nearly all the litigation concerning the bounds on Federal and State jurisdiction since the enactment of the FPA has been fought over how to properly interpret the FPA's authorities and limitations, and the resulting preemption of state action under the Supremacy Clause.[26]

The Commission's interpretation of its jurisdiction under the FPA has generally been granted deference by reviewing courts, whether before or after the *Chevron* decision announced now-familiar principles for reviewing agency interpretations of statutes they administer.[27] So, for instance, the courts have sustained the Commission's interpretations that it has authority over wholesale sales between two parties in a single state if the state is part of a larger multistate transmission interconnection (*Colton*), and that it has jurisdiction over unbundled retail transmission (*New York v. FERC*).

One question under FPA Section 201 was whether the transmission of electricity between two points in a state, or a wholesale sale between two parties in a single state, was in interstate commerce and thus subject to FPA jurisdiction.[28] In 1964, the Supreme Court addressed this

[26] *Cf. North Dakota v. Heydinger*, 825 F.3d 912 (8th Cir. 2016) (a decision invalidating a Minnesota law limiting sales of electricity from out-of-state coal-fired generators to utilities in Minnesota, with one judge finding the law invalid under the dormant Commerce Clause, a second finding it preempted by the FPA, and the third finding it preempted by the Clean Air Act).

[27] *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

[28] In *Connecticut Light & Power Co. v. FPC*, the Supreme Court noted that the interconnected nature of the industry is "such that if any part of a supply of electric energy comes from outside of a state it is, or may be present in every connected distribution facility." 324 U.S. 515, 529 (1945). As a result, the Commerce Clause authority for Congress to regulate interstate commerce could in theory extend Federal regulation to "a toaster on the breakfast

question in its "*Colton*" decision: *FPC v. Southern California Edison Co*.[29] *Colton* involved a wholesale sale of out-of-state power by a public utility, Southern California Edison Company, to a municipal utility in the same state, the City of Colton. The United States Court of Appeals for the Ninth Circuit found that the wholesale sale was subject to *state* regulation, relying on the language of FPA Section 201(a) – that the FPC's jurisdiction "extend[s] only to those matters which are not subject to regulation by the states" – coupled with its finding that state regulation of the Edison-Colton sale was permissible under the Commerce Clause.[30] Under the Ninth Circuit's interpretation of FPA Section 201(a), "the FPC could not assert its jurisdiction over a sale which the Commerce Clause allowed a State to regulate."[31]

The Supreme Court, however, disagreed with the Ninth Circuit's reasoning and reversed.[32] The Court clarified that "Section 201(b) embodies a clear grant of power."[33] By contrast, the Court found that "§ 201(a) was merely a 'policy declaration . . . of great generality. It cannot nullify a clear and specific grant of jurisdiction, even if the particular grant seems inconsistent with the broadly expressed purpose.'"[34] Thus, the Court concluded that "Congress meant to draw a *bright line* easily ascertained, between state and federal jurisdiction . . . making FPC jurisdiction plenary and extending it to all wholesale sales in interstate commerce except those which Congress has made explicitly subject to regulation by the States."[35]

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table." 324 U.S. at 529. The Court explained that the limiting language of Section 201 of the FPA prevents this result. 324 U.S. at 529-31.

[29] 376 U.S. 205, *reh'g denied*, 377 U.S. 913 (1964) (C*olton*).

[30] *Colton*, 376 U.S. at 209-10.

[31] *Colton*, 376 U.S. at 210.

[32] *Colton*, 376 U.S. at 216.

[33] *Colton*, 376 U.S. at 215.

[34] *Colton*, 376 U.S. at 215 (citing *Conn. Light & Power Co. v. FPC*, 324 U.S. at 527).

[35] *Colton*, 376 U.S. at 215-16 (emphasis added). Later cases developed the "commingling" test used today, under which particular facilities or utilities fall under FPA jurisdiction if any portion of the electricity involved is transmitted to or from another state. *See FPC v. Fla. Power & Light Co.*, 404 U.S. 453, *reh'g denied*, 405 U.S. 948 (1972).

The extent of Federal jurisdiction over transmission of electric energy was later considered in *New York v. FERC*,[36] in which the Court upheld FERC's landmark Order No. 888. In particular, the Court upheld FERC's authority to apply Order No. 888's requirements to unbundled retail transmission of electricity[37] against a challenge from New York, which asserted that such transmission supports a retail transaction and is thus subject to State retail regulatory authority.[38] The Court concluded that such transmissions "are indeed transmissions of 'electric energy in interstate commerce,' because of the nature of the national grid," and that "[t]here is no language in the statute limiting FERC's *transmission* jurisdiction to the wholesale market, although the statute does limit FERC's *sale* jurisdiction to that at wholesale."[39]

In Order No. 888, FERC specifically declined to assert authority over the transmission portion of *bundled* retail transactions in order to avoid potentially disruptive shifts in jurisdiction. The Supreme Court concluded that this was a "statutorily permissible policy choice," without deciding the issue of whether FERC could have asserted such authority.[40]

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[36] 535 U.S. 1 (2002).

[37] Unbundled retail transmissions are those made by utilities that have either voluntarily, or at the direction of their State regulator, separated the transmission function from the retail sales function, offered their customers retail access, and transmitted power sold by others to retail customers.

[38] *New York v. FERC*, 535 U.S. at 16.

[39] *New York v. FERC*, 535 U.S. at 17.

[40] *New York v. FERC*, 535 U.S. at 27-28 ("[E]ven if we assume… that… the FPA gives FERC the authority to regulate the transmission component of a bundled retail sale, we nevertheless conclude that the agency had discretion to decline to assert such jurisdiction in this proceeding in part because of the complicated nature of the jurisdictional issues."). The Court agreed with FERC that the prospect of asserting jurisdiction over all retail transmissions would have "implications for the States' regulation of retail sales – a state regulatory power recognized by the same statutory provision that authorizes FERC's transmission jurisdiction." *New York v. FERC*, 535 U.S. at 28. The partial dissent by Justice Thomas, joined by Justices Scalia and Kennedy, argued that there was no question as to FERC's statutory authority to regulate the transmission portion of bundled retail service: "Because the statute unambiguously grants FERC jurisdiction over all interstate transmission and § 824e mandates that FERC remedy undue discrimination with respect to all transmission within its jurisdiction, at a minimum the statute required FERC to consider whether there was discrimination in the marketplace warranting application of either the OATT or some other remedy." *New York v. FERC*, 535 U.S. at 42 (J. Thomas, concurring in part and dissenting in part).

III. Current Issues at the Interface of Federal and State Jurisdiction

Part II of the FPA uses factors such as customer type (wholesale v. retail), facility type (generation v. transmission v. distribution), geography (interstate commerce v. intrastate commerce), and utility type (public utility v. public power) to divide exclusive regulatory responsibilities between Federal and State regulators. However, applying what *Colton* characterized, in 1964, as this "bright line easily ascertained" between Federal and State regulatory jurisdiction has become more complex with recent technology and market changes in the power sector. Discussed below are three examples of current issues raising questions about the reach of Federal and State regulation. Other ongoing developments, including electricity storage, electric vehicles and microgrids, may raise similar jurisdictional questions.

A. Demand Response Participating in Wholesale Markets

Demand response refers generally to the ability of customers to reduce their electricity consumption, based either on an upfront commitment to do so when called upon by the system operator or in response to price signals. Since the early 2000s, RTOs/ISOs have allowed retail end-users, or aggregators of end users, to submit offers "to decrease electricity consumption by a set amount at a set time for a set price"[41] into wholesale energy and capacity markets.[42] As the Supreme Court has noted, "[t]he wholesale market operators treat those [demand response] offers just like bids from generators to increase supply."[43] In the Energy Policy Act of 2005, Congress established policy in favor of reducing barriers to participation of demand response in wholesale markets.[44]

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[41] *FERC v. Elec. Power Supply Ass'n*, 136 S. Ct. 760, 770 (2016).
[42] *See, e.g.*, *PJM Interconnection, L.L.C.*, 95 FERC ¶ 61,306 (2001); *Cal. Indep. Sys. Operator Corp.*, 91 FERC ¶ 61,256 (2000).
[43] *FERC v. Elec. Power Supply Ass'n*, 136 S. Ct. at 770.
[44] Energy Policy Act of 2005, Pub. L. No. 109-58, § 1252(f), 119 Stat. 594, 966 (2005) ("It is the policy of the United States that . . . unnecessary barriers to demand response participation in energy, capacity, and ancillary service markets shall be eliminated.").

In 2011, FERC issued Order No. 745, which required that, if established prerequisites and conditions are met, a "demand response resource must be compensated for the service it provides to the energy market at the market price for energy."[45] Opponents of Order No. 745 argued, in part, that FERC lacked authority to regulate the price paid to demand response resources because demand response involves retail consumption and retail sales, which are matters reserved to the authority of the States. FERC rejected these arguments.

On judicial review, the United States Court of Appeals for the District of Columbia Circuit vacated Order No. 745, agreeing with opponents that FERC lacked jurisdiction to regulate the participation of demand response resources in the wholesale market. Specifically, while acknowledging that demand response compensation is a practice that "affects the wholesale market" under Sections 205 and 206, the court found that FERC's "jurisdiction to regulate practices 'affecting rates' does not erase the specific limit[]" imposed by the FPA on FERC regulation of retail rates.[46] The court held that Order No. 745 exceeded this limit because, in luring retail customers into the wholesale market, and causing them to decrease "levels of retail electricity consumption," the rule engages in "direct regulation of the retail market."[47]

The Supreme Court reversed the D.C. Circuit's jurisdictional determination and upheld Order No. 745.[48] First, the Court found that FERC's assertion of authority fit within its authority under Section 206 of the FPA to remedy "any rule, regulation, *practice*, or contract affecting" a rate or charge subject to its jurisdiction. In reaching this conclusion, the Court acknowledged that FERC's authority to address "practices" affecting wholesale rates is not boundless, finding

[45] *Demand Response Compensation in Organized Wholesale Energy Markets*, Order No. 745, 76 Fed. Reg. 16,658 (Mar. 4, 2011), FERC Stats. & Regs. ¶ 31,322, at PP 2, 48, *order on reh'g & clarification*, Order No. 745-A, 137 FERC ¶ 61,215 (2011), *reh'g denied*, Order No. 745-B, 138 FERC ¶ 61,148 (2012), *vacated sub nom. Elec. Power Supply Ass'n v. FERC*, 753 F.3d 216 (D.C. Cir. 2014), *rev'd & remanded sub nom. FERC v. Elec. Power Supply Ass'n*, 136 S. Ct. 760 (2016).
[46] *Elec. Power Supply Ass'n v. FERC*, 753 F.3d at 222.
[47] *Elec. Power Supply Ass'n v. FERC*, 753 F.3d at 223-24.
[48] *FERC v. Elec. Power Supply Ass'n*, 136 S. Ct. 760.

that such practices must *directly* affect jurisdictional rates.[49] Applying that "common-sense" limit, the Court concluded that "the practices at issue in the Rule – market operators' payments for demand response commitments – *directly* affect *wholesale* rates."[50]

Secondly, the Supreme Court found that Order No. 745 does not directly regulate retail electricity sales, contrary to the holding of the D.C. Circuit. While the Court conceded that any regulation of wholesale electricity sales will naturally affect retail rates in some way, it made clear that such affect "is of no legal consequence."[51] The Court found: "When FERC regulates what takes place on the wholesale market, as part of carrying out its charge to improve how that market runs, then no matter the effect on retail rates, § 824(b) imposes no bar. And in setting rules for demand response, that is all FERC has done."[52] The Court further found that FERC's "notable solicitude toward the States" – specifically its decision to continue to allow States to "opt out" and prohibit their retail customers from participating in the wholesale market – "removes any conceivable doubt as to [Order No. 745's] compliance with [the FPA's] allocation of federal and state authority."[53]

B. State Generation Programs and Capacity Markets

Several RTOs/ISOs[54] operate mandatory centralized capacity auction markets through which retail sellers of electricity must acquire capacity (*i.e.*, the availability to produce energy

[49] *FERC v. Elec. Power Supply Ass'n*, 136 S. Ct. at 764 (citing *Cal. Indep. Sys. Operator Corp. v. FERC*, 372 F.3d 395, 403 (D.C. Cir. 2004)).
[50] *FERC v. Elec. Power Supply Ass'n*, 136 S. Ct. at 773 (emphasis added). In considering whether FERC's action in Order No. 745 amounted to an impermissible direct regulation of retail rates, the Court also looked to the "'target at which [it] . . . aims,'" and concluded that FERC's rationale for the order was "all about, and only about, improving the wholesale market." *FERC v. Elec. Power Supply Ass'n*,, 136 S. Ct. at 776-77 (quoting *ONEOK, Inc. v. Learjet, Inc.*, 135 S. Ct. 1591, 1599 (2015)).
[51] *FERC v. Elec. Power Supply Ass'n*,, 136 S. Ct. at 764, 776.
[52] *FERC v. Elec. Power Supply Ass'n*,, 136 S. Ct. at 776.
[53] *FERC v. Elec. Power Supply Ass'n*,, 136 S. Ct. at 779-80.
[54] Specifically, PJM Interconnection, L.L.C., (PJM), the New York Independent System Operator, and ISO New England.

when called upon) sufficient to cover their projected peak demand.[55] Maryland, concerned that the PJM capacity auction "was failing to encourage development of sufficient new in-state generation,"[56] adopted a program to support development of generation capacity to be built within the state. The state program identified a developer to build new gas-fired generation at a specified location, required the generator to bid into the PJM capacity market, and required load-serving entities in the state to execute "contracts for differences" with the developer to pay, or be paid, the difference between the price the developer received in the capacity market and the fixed price established in the contract.

The Maryland program faced legal challenges from existing generators, arguing that the state program, by setting the price that generators would receive for selling capacity, conflicted with Federal law and FERC's capacity market policies and was thus preempted under the Supremacy Clause. In *Hughes*, the Supreme Court unanimously held that Maryland's program impermissibly conflicted with and was preempted by Federal law.[57] The Court found that the program "sets an interstate wholesale rate, contravening the FPA's division of authority between state and federal regulators."[58] By guaranteeing to the developer a rate for capacity different from the capacity rate resulting from PJM's capacity auction, the Court found that Maryland's program adjusts an interstate wholesale rate, and thus, impermissibly "invades FERC's regulatory turf."[59]

The Court emphasized that its holding was limited, explaining that states "may regulate within the domain Congress assigned to them [under the FPA] even when their laws incidentally

[55] *Hughes v. Talen Energy Mktg.*, 136 S. Ct. 1288, 1293 (2016) (Hughes).
[56] *Hughes*, 136 S. Ct. at 1294.
[57] *Hughes*, 136 S. Ct. 1288. A similar New Jersey program was also found preempted and invalidated, on substantially similar grounds, by the United States Court of Appeals for the Third Circuit in *PPL EnergyPlus v. Solomon*, 766 F.3d 241, 246 (3rd Cir. 2014), *cert. denied sub nom., CPV Power Holdings, LP v. Talen Energy Marketing, LLC*, 136 S. Ct. 1728 (2016).
[58] *Hughes*, 136 S. Ct. at 1297.
[59] *Hughes*, 136 S. Ct. at 1297.

affect areas within FERC's domain."[60] But states "may not seek to achieve ends, however legitimate, through regulatory means that intrude on FERC's authority over interstate wholesale rates."[61] In this regard, the "fatal defect that renders Maryland's program unacceptable," the Court explained, was the fact that it "condition[ed] payment of funds on capacity clearing the auction."[62] Nothing in the opinion, the Court emphasized, "should be read to foreclose" states from "encouraging production of new or clean generation through measures 'untethered to a generator's wholesale market participation.'"[63] Thus, the Court noted that it was not addressing "the permissibility of various other measures States may 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."[64]

As states consider different policies, such as policies intended to keep existing nuclear plants in operation, the bounds of what states can and cannot do without running into FPA preemption may have to be further litigated to obtain clear answers.

C. Net Metering for Distributed Renewable Generation

Net metering of distributed generation presents potentially thorny questions of state and federal regulatory jurisdiction. A distributed generator participating in a net metering program provides excess electricity to a distribution utility that will resell the power to another consumer in exchange for a bill credit at the retail electric rate – that is, the distributed generator arguably makes wholesale sales (at least for periods when on-site generation exceeds on-site load). Such sales could, in theory, subject on-site generators to Federal regulatory jurisdiction over wholesale sales.

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[60] *Hughes*, 136 S. Ct. at 1298.
[61] *Hughes*, 136 S. Ct. at 1298.
[62] *Hughes*, 136 S. Ct. at 1299.
[63] *Hughes*, 136 S. Ct. at 1299.
[64] *Hughes*, 136 S. Ct. at 1299.

FERC has largely disclaimed jurisdiction over net-metering arrangements to date, concluding that net-metering does not constitute a wholesale sale subject to its jurisdiction "when the owner of the generator receives a credit against its retail power purchases from the selling utility" and remains a net buyer over the relevant utility billing period. FERC has made a series of interpretations of its jurisdiction that allow state net metering programs to continue without Federal regulatory interference.[65] Asserting Federal jurisdiction over a very large number of very small entities selling relatively little electricity to the electric system in direct response to supportive state policy would arguably provide little public benefit.

FERC's decisions to date rest on finding that net metering consumers are merely "offsetting" consumption with on-site generation and are not selling at wholesale. This construct is increasingly under strain, however. Some state are considering distributed generation policies that move away from traditional net-metering, however, and toward more complex regulatory and pricing systems aimed at more directly compensating distributed generation for the variety of grid services that such generation can provide.[66] Such new policies may require a different jurisdictional analysis.

IV. Conclusion

Although Part II of the Federal Power Act has been amended over the years since its enactment in 1935, its core provisions on FERC jurisdiction and its core standards for reviewing rates, terms and conditions of transmission service and wholesale sales have remained largely the

[65] *MidAmerican Energy Co.*, 94 FERC ¶ 61,340 (2001); *Standardization of Generator Interconnection Agreements and Procedures*, Order No. 2003, 68 Fed. Reg. 49,845 (Aug. 19, 2003), FERC Stats. & Regs., ¶ 31,146 (2003), *order on reh'g*, Order No. 2003-A, 69 Fed. Reg. 15,932 (Mar. 26, 2004), FERC Stats. & Regs. ¶ 31,160, at P 747, *order on reh'g,* Order No. 2003-B, 70 Fed. Reg. 265 (Jan. 4, 2005), FERC Stats. & Regs. ¶ 31,171, *order on reh'g,* Order No. 2003-C, FERC Stats. & Regs. ¶ 31,190 (2005), *aff'd sub nom. Nat'l Ass'n of Regulatory Util. Comm'rs v. FERC*, 475 F.3d 1277 (D.C. Cir. 2007), *cert. denied*, 552 U.S. 1230 (2008); *Sun Edison LLC*, 129 FERC ¶ 61,146, at P 18 (2009), *order on reh'g*, 131 FERC ¶ 61,213 (2010).

[66] *See, e.g.*, Mike Taylor et al., National Renewable Energy Laboratory, Value of Solar: Program Design and Implementation Considerations (March 2015), http://www.nrel.gov/docs/fy15osti/62361.pdf.

same. The Commission has deployed these flexible authorities, with targeted statutory amendments by Congress, to adjust the Federal regulatory approach in the face of changes in the power sector's organization and changes in technology.

It is worth noting that, while the categories of activities that are subject to the core FPA regulation – wholesale sales in interstate commerce and transmission in interstate commerce – have not changed, the volume of activity within those categories has grown exponentially with changes in the industry, increasing the influence of Federal regulatory policies on the shape of the industry. The number of "public utilities" subject to FERC regulation has increased, with new entry of IPPs and marketers far outstripping the effect of consolidation among traditional investor-owned utilities. Moreover, with the restructuring of a number of utilities, the growth in IPPs, and the emergence of organized energy and capacity markets in many regions, the volume of FERC-jurisdictional wholesale sales has grown dramatically. Likewise, with the advent of open access transmission requirements and RTOs, there are many more transmission transactions now than there were 25 years ago.

The statutory "bright line" between Federal and State regulation remains largely as it was when the *Colton* Court coined that phrase, but applying those jurisdictional principles is a growing challenge. The Commission and the courts are being called on to address novel questions of jurisdiction with increasing frequency. In the first instance, these new questions will be addressed by FERC, and by State regulators and legislators, subject to judicial review on whether their actions are consistent with the split of regulatory authority set out in the FPA. If those outcomes become untenable from a policy or political perspective, Congress, as the ultimate arbiter of this jurisdictional split, can expect pleas that they become engaged in considering reforms to the current statutory arrangements.

I look forward to addressing any questions you might have.