**High Wholesale Prices: States' Paths for Protection**

**Scott Hempling, Attorney at Law LLC**

**Where Did Maryland and New Jersey Go Wrong?**

**Legal Error: Five Factors, Simultaneously**

Compel utilities to enter into a contract with wholesale seller to build generation.

Contract guarantees seller a long‑term revenue stream, secured by a contract for differences (CfD).

CfD reconciles the differences between the guaranteed revenue stream and the RTO market price.

Revenue guarantee is conditioned on seller bidding in and clearing the RTO market.

Source of the revenue stream: captive retail ratepayers.

**It's the Means, Stupid**

"If a state‑supported bid clears the auction market when it would not have done so without the state support, another unsupported bid (which otherwise would have cleared) may not clear. The lower market‑clearing price that results ... distorts the price signals that would otherwise indicate a need for new capacity." (4th Cir.)

Preemption "turns on 'the target at which the state law aims.'" (S.Ct.)

"[T]he program directly targets the PJM market mechanism for setting the wholesale capacity rate....[It] partially displaces the market mechanism for setting wholesale price signals for new generators." (4th Cir.)

"We reject Maryland's program ... because it disregards an interstate wholesale rate required by FERC." (S.Ct.)

"That Maryland was attempting to encourage construction of new in state generation does not save its program...." (S.Ct.)

"...States may not seek to achieve ends, however legitimate, through regulatory means that intrude on FERC's authority over interstate wholesale rates...." (S.Ct.)

**The New "Bright Line": "Direct" vs. "Indirect"**

"Congress meant to draw a bright line, easily ascertained, between state and federal jurisdiction." *Southern Calif. Edison Co.*

**Understanding "Direct**"

The statute distinguishes between "measures aimed directly at interstate purchasers and wholesalers for resale, and those aimed at subjects left to the States to regulate." *Oneok*.

State requires interstate pipelines to obtain state approval before issuing long‑term securities: Preempted, because 'directed at . . . the control of rates and facilities of natural gas companies,' 'precisely the things over which FERC has comprehensive authority.'" *Schneidewind* (explained in *Oneok*).

The focus should be on "what the State seeks to regulate . . . , not why the State seeks to regulate it." Scalia and Roberts, dissenting in *Oneok*.

"[T]he practices at issue in the Rule‑‑market operators' payments for demand response commitments‑‑directly affect wholesale rates." *EPSA*.

"[T]he program directly targets the PJM market mechanism for setting the wholesale capacity rate....[It] partially displaces the market mechanism for setting wholesale price signals for new generators." (4th Cir.)

**Understanding "Indirect"**

Under FPA Section 206(a), "FERC has the authority‑‑and, indeed, the duty‑‑to ensure that rules or practices "affecting" wholesale rates are just and reasonable." *EPSA*.

"Taken for all it is worth, that statutory grant could extend FERC's power to *some surprising places*. As the court below noted, markets in *all electricity's inputs*‑‑steel, fuel, and labor most prominent among them‑‑might affect generators' *supply of power*. ... And for that matter, markets in just about everything‑‑the whole economy, as it were‑‑might influence LSEs' *demand*. So *if indirect or tangential impacts on wholesale electricity rates sufficed, FERC could regulate now in one industry, now in another*, changing a vast array of rules and practices to implement its vision of reasonableness and justice. We cannot imagine that was what Congress had in mind." *EPSA*.

"As we have explained in addressing similar terms like "relating to" or "in connection with," a *non‑hyperliteral reading* is needed to prevent the statute from assuming *near‑infinite breadth*." *EPSA*.

"For that reason, an earlier D. C. Circuit decision adopted, and we now approve, a common‑sense construction of the FPA's language, limiting FERC's 'affecting' jurisdiction to rules or practices that 'directly affect the [wholesale] rate.'" *EPSA*.

"FERC regulation does not run afoul of sec. 824(b)'s proscription just because it affects‑‑even substantially‑‑the quantity or terms of retail sales. It is a fact of economic life that the wholesale and retail markets in electricity, as in every other known product, are not hermetically sealed from each other. To the contrary, transactions that occur on the wholesale market have natural consequences at the retail level. And so too, of necessity, will FERC's regulation of those wholesale matters." *EPSA*.

**The States' Self‑Inflicted Wounds**

**Maryland's "Questions Presented"**

"When a seller *offers to build generation and sell wholesale power on a fixed‑rate contract basis*, does the FPA field‑preempt a state order directing retail utilities to enter into the contract?" [*What's missing?*]

"Does FERC's acceptance of an annual regional capacity auction preempt states from requiring retail utilities to contract at fixed rates with sellers who are willing to commit to sell into the auction on a long‑term basis?" [*What's missing?*]

"The primary question here is whether, in according FERC exclusive authority over wholesale rates, Congress implicitly foreclosed states from doing what Maryland did: decide that it needed new generation facilities, conduct a competitive procurement, and direct state‑regulated utilities to accept the best proposal by a generation developer to build a new facility and offer its capacity and energy to a regional market for twenty years." [*What's missing?*]

"So long as a state neither controls a FERC‑jurisdictional seller's decision whether and on what terms to sell, nor determines or second‑guesses FERC's determination whether that rate is reasonable, the state remains on its side of the line." [*What's missing?*]

**FPA "Power Grab": On Whose Foot Does the Shoe Fit?**

The North Carolina Commission was conflict‑preempted when it treated a retail utility as having access to more low‑cost, wholesale hydropower than the limited amount allocated to the utility by FERC. *Nantahala Power & Light Co.* (7‑0)

The Mississippi Commission was conflict‑preempted when the state Attorney General demanded that it investigate the prudence of a utility's subsidiary's purchase of high‑cost nuclear capacity allocated to it by a FERC‑approved wholesale contract. *Mississippi Power & Light Co.*  (6‑3)

FERC did not exceed its FPA authority in exercising jurisdiction over the unbundled transmission of retail electricity. *New York v. FERC.* (9‑0)

Louisiana was conflict‑preempted from disallowing from a utility's retail rates costs charged to that utility under a FERC‑authorized cost allocation agreement. *Entergy Louisiana.* (8‑0).

FERC did not exceed its jurisdiction in approving (with modifications) an allocation of wholesale generating capacity among affiliated retail utilities of a centrally planned holding company, even though the allocation would affect retail rates. *Mississippi Industries.* (3‑0)

FERC did not exceed its jurisdiction in requiring that a utility could not use its state law eminent domain powers for its own interconnection facilities unless it offered to use the same powers for its competitors. *NARUC v. FERC.* (2‑1)

FERC did not exceed its jurisdiction in allocating among retail utilities responsibility for having sufficient capacity relative to load. *Connecticut DPUC v. FERC.* (3‑0)

FERC did not violate the Tenth Amendment when it allocated costs of a regional transmission network among the retail utilities that use the network. *Illinois Commerce Comm'n v. FERC.* (3‑0)

FERC did not exceed its jurisdiction by eliminating the exemption from the minimum offer price rule for state‑mandated resources; FERC's action was not direct regulation of generating facilities. *New Jersey Bd. of Public Utilities.* (3‑0)

**Why Do States Bring Losing Cases?**

The jurisdictional boundaries established in a 1935 do not work well in 2016. But statutory mismatch does not equal statutory ambiguity. If the Federal Power Act's boundaries were ambiguous, one would expect more judges to side with states more often. They don't. So why we keep trying, and why we keep losing, is worth some soul‑searching.

Do we conflate disagreements over policy with disputes over jurisdiction?

Do we view "states" as stakeholders in a FERC‑regulated industry (the wrong view) rather than as co‑regulators with FERC in a changing industry (the right view)?

Do we view federal vs. state as a zero‑sum struggle rather than federal *and* state as bijurisdictional partnership?

Whatever the reasons, the approach is not working.

**What are the Consequences**?

By mis‑casting differences over policy as attacks on jurisdiction, we create a culture of us vs. them. The resulting divisiveness makes cooperation politically difficult, because those displaying some appreciation for the "other" risk being viewed as betrayers of their allies. These differences harden over time, as each new crop of commissioners absorbs the leanings of their predecessors.

Losing so often reduces the respect states deserve from the very fora whose deference they seek and need‑‑FERC and the courts.

Unnecessary appeals create investment uncertainty, for both sellers and buyers, because during the multi‑year appellate period no one knows the rules.

We waste lawyer time reading and signing each others' appellate briefs.

**How Can States Avoid Future Errors?**

**Direct vs. Indirect = Price‑Fixing vs. Curve‑Shifting**

Distinguish: (a) policies that shift supply and demand curves from (b) policies that fix compensation for particular sellers. Curve‑shifting *affects* the market price indirectly but does not *set* the market price.

**State shifts the supply curve to the right.**

State can lower the cost of inputs for in‑state generation, by reducing taxes, subsidizing land and improvements, providing training to generation operators, reducing environmental requirements.

Each such state action shifts the recipient generation company's supply curve rightward, thus shifting the market supply curve rightward. This shift means the supply curve intersects the demand curve at a lower price.

The effect on FERC‑jurisdictional prices is indirect, not direct.

But each seller's compensation will still be determined, directly and entirely, by the FERC‑jurisdictional market price. There is no *"correcting" of any wholesale seller's compensation* through a state‑ordered payment.

Maryland did not shift the supply curve. Maryland *set the compensation to be received by the wholesale generator* for making a FERC‑jurisdictional sale‑‑the practical equivalent of setting a FERC‑jurisdictional price.

**State shifts demand curve to the left**

The state can give away sweaters and compact fluorescent light bulbs, tighten building codes, tax consumption, set high retail prices during peak periods, or pay consumers to reduce demand and consumption.

These actions shift that state's demand curve leftward, causing it to intersect the wholesale market supply curve at a lower price. Again, that lower price‑a FERC‑jurisdictional price‑is affected by the state, but it is not set by the state.

Again, the effect on FERC‑jurisdictional prices is indirect, not direct.

**What States Can Do**

"Our holding is limited: We therefore need not and do not address the permissibility of 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. Nothing in this opinion should be read to foreclose Maryland and other States from encouraging production of new or clean generation through measures "untethered to a generator's wholesale market participation." *Hughes*.

So long as a State does not condition payment of funds on capacity clearing the auction, the State's program would not suffer from the fatal defect that renders Maryland's program unacceptable." *Hughes*.

So states can do can do their own curve‑shifting: by opening their retail markets to curtailment service providers; and by defining prudent utility practice as bringing to the RTO markets wholesale demand curves that reflect all cost‑effective demand response, with appropriate financial consequences for succeeding or failing to act prudently.

What Else?

Establish mix between utility build and utility wholesale purchase.

Determine the market structure for demand response (e.g., utility monopoly vs. competitive aggregation market)

Establish resource mix (e.g., conventional, renewable, energy efficiency, demand response).

Dampen demand by requiring utilities to accept all cost effective DR.

Use the Order 1000 process to advance a region's common state interests

And states can require their retail utilities to hedge, using CfDs. "Our opinion does not call into question whether generators and LSEs may enter into long‑term financial hedging contracts based on the auction clearing price. Such contracts, also frequently termed contracts for differences, do not involve state action to the same degree as Maryland's program, which compels private actors (LSEs) to enter into contracts for differences‑like it or not‑with a generator that must sell its capacity to PJM through the auction." *Hughes*.