June 26, 2009

ENERGY ALERT

COURT OF APPEALS UPHOLDS FERC'S AUTHORITY TO REGULATE CAPACITY REQUIREMENTS

On June 23, 2009, the United States Court of Appeals for the D.C. Circuit rejected the Connecticut Department of Public Utility Control's (DPUC) challenge to the Federal Energy Regulatory Commission's (FERC or Commission) jurisdiction to review the Installed Capacity Requirement (ICR) underlying ISO New England Inc.'s (ISO-NE) Forward Capacity Market (FCM).[1]

The DPUC consistently has argued that the Commission's review of the ICR constitutes direct regulation of electric generation and is not permitted under the Federal Power Act (FPA). The Connecticut attorney general, the Maine Public Utilities Commission and the Massachusetts Department of Public Utilities intervened, and the National Association of Regulatory Utility Commissioners and the Ohio attorney general, among others, participated as amici, in support of the DPUC. The New England Power Pool Participants Committee and ISO-NE, among others, intervened, and PJM Interconnection, L.L.C. and the Electric Power Supply Association participated as amici, in support of the FERC.

The opinion starts with a brief history of the development of the FCM and an explanation of the role the ICR plays in the FCM. The court then notes that, in rejecting an earlier challenge to the FERC's authority to create and review the operation of the FCM, it explicitly reserved the issue of whether the FERC's review of the ICR exceeded its jurisdiction because that issue already was before the court in these consolidated appeals. The court further notes that it initially remanded the case, so that the FERC could explain the statutory basis for its jurisdiction to review the ICR, and that, on remand, the FERC explained that "'ISO-NE's ICRs have a significant and direct effect on jurisdictional rates and services, [and] therefore fall within the Commission's jurisdiction.'"[2]

The court's decision rests on a "twin pair of concessions" that simplify the case. First, petitioner concedes that the Commission may determine just and reasonable capacity charges and that it may set those charges to incentivize procurement or creation of additional capacity. Second, the Commission conceded that the FPA precludes it from directly regulating generating facilities. In light of these concessions, the issue before the court simply was whether "setting the ICR

[1] *Conn. Dep't of Pub. Util. Control v. FERC*, Nos. 07-1375, *et al.* (D.C. Cir. June 23, 2009) (opinion available here).
[2] Slip op. at 7 (*quoting ISO New England, Inc.*, 122 FERC ¶ 61,144 at 61,763, *reh'g denied*, 123 FERC ¶ 61,036 (2008)).

represent[s] the kind of direct regulation of generation facilities plainly forbidden by [FPA] section 201."[3] The court concludes that it does not.

The court bases this conclusion on the nature of the ICR, which it finds is more like a peak demand estimate than a requirement to build additional capacity. The court also holds that its own precedent in *Municipalities of Groton v. FERC*, 587 F.2d 1296 (D.C. Cir. 1978), holding that the Commission has the power to establish directly the price of capacity, leads inevitably to the conclusion that the Commission may establish the price indirectly by setting a target for capacity demand. In addition, the court notes that there are options for responding to increases in the ICR other than building new capacity, such as demand response and importing capacity.

The court rejects the DPUC's argument that the Commission lacks not only jurisdiction to compel the construction of new capacity but also jurisdiction to compel load-serving entities to acquire a certain amount of capacity. In this regard, the court finds that nothing in the FPA proscribes such authority. The court further finds that, even if there were such a prohibition, the Commission's review of the ICR does not, in fact, impose such a requirement but, rather, is part of its review to ensure that capacity charges are just and reasonable. Finally, the court holds that, even if the applicable statutory provisions could be read to impose such a prohibition, and even if this is what the Commission were doing, the court's prior explicit finding in *Municipalities of Groton*, that the Commission has authority to review deficiency charges imposed by ISO-NE, controls and is supported by other court precedent.

Finally, the court rejects the DPUC's argument that the ICR has no effect on jurisdictional rates, noting that, while that may be true as a matter of economic theory, in the real world, the ICR does affect price. The court also finds that, even if the ICR only helped find the right price, it would still be a "'practice . . . affecting rates'" and within the Commission's jurisdiction.[4]

The court *sua sponte* ordered that the mandate on its judgment denying the DPUC's petitions for review should not issue until seven days after disposition of any timely petition for rehearing or petition for rehearing en banc.

[3] *Id*. at 8.
[4] *Id*. at 15 (quoting FPA section 206(a), 16 U.S.C. § 824e(a)).

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