Emerging Issues in the Federal Regulation of Electricity Markets

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In 2015, the Federal Energy Regulatory Commission (FERC) will address many of the most serious challenges the electric industry faces in multiple proceedings that will be closely followed by industry participants. Those challenges include the retirement of substantial portions of the nation's generation fleet and the changing composition of that fleet due to the increased use of natural gas and renewable resources.

Fuel Assurance. In late 2014, FERC required all regional market operators to determine whether the generators in their regions have sufficient fuel supplies to handle severe weather events such as the "polar vortex" of 2014. PJM Interconnection, LLC, the largest organized market in the nation, has submitted a proposal to overhaul its generating capacity product to enhance fuel assurance. FERC will approve, modify or reject this "capacity performance" proposal in early 2015.

EPA Regulation. The Environmental Protection Agency (EPA) has adopted or proposed several rules with significant impacts on the electric power sector, including adopting the Mercury Air and Toxics Standard (which regulates plant emissions of certain hazardous air pollutants) and proposing the Clean Power Plan (which regulates greenhouse gas emissions. (See "Ambitious EPA Plan Would Require States to Reduce CO2 Emissions at Existing Power Plants.") Although FERC's role in connection with EPA initiatives is limited, several Midwest utilities already have asked FERC for exemptions from capacity market rules, due to EPA compliance obligations. More requests may follow in 2015. Hearings before the energy committees in both the U.S. House of Representatives and Senate on FERC's role in addressing the impact of the EPA regulations also are probable, with many Republicans likely urging for greater FERC involvement determining reliability impacts. For example, one major issue will be whether transmission system reinforcements necessary to address coal plant retirements can be constructed quickly enough to maintain reliability.

Reliability Standards. The North American Electric Reliability Corp. (NERC), which is responsible for grid reliability and is subject to FERC oversight, will implement multiple new standards on key reliability issues in 2015, including physical and cybersecurity standards to protect against terrorism. Given increasing concerns over cyberattacks on U.S. businesses and infrastructure, the industry's success in implementing these standards will have a significant impact on whether Congress is asked to adopt legislation to enhance FERC's powers in this area.

Gas-Electric Coordination. Electric and natural gas markets do not use the same daily scheduling protocols, which means electric generators often have to make gas supply decisions before they know whether they will be obligated to produce electricity the next day. FERC has proposed changes that will reduce these inefficiencies and will continue to press both the electric and natural gas industries on this issue in 2015.

Efficient Price Formation. FERC will take multiple actions in 2015 designed to increase the efficiency of bid-based ("organized") markets that are administered by a neutral grid operator. FERC has issued a series of white papers on flaws in these markets that can result in inefficient price formation during times of scarcity. In November 2014, FERC required grid operators to address fuel assurance, and FERC is likely to take action to address this issue in 2015.

Demand Response. A steadily growing portion of the capacity resources in organized electric markets in recent years has been supplied by retail customers willing to reduce their consumption during times of shortage. However, the D.C. Circuit in 2014 struck down FERC's landmark rule regulating demand response payments in the energy markets, holding that only the states, not FERC, have authority to regulate these payments. In mid-January 2015, the U.S. solicitor general asked the Supreme Court to review and reverse that ruling. Several complaints also have been filed pressing FERC to remove demand response from the capacity market auctions scheduled in early 2015. FERC action on these complaints, as well as the Supreme Court's decision on whether to review the D.C. Circuit ruling, are expected in March-April 2015.

Transmission Infrastructure. FERC has long supported policies that facilitate the construction of new transmission infrastructure but is now grappling with several tensions in this area. One such tension involves FERC's policy, enunciated in Order 1000, to open bidding on new transmission projects to any qualified entity, which state governments contend intrudes on their traditional siting jurisdiction. The first competitive solicitations are being held in many regions, and it appears likely that FERC will be asked to resolve disputes over results in some cases. Another continuing tension involves the effort to provide financial incentives that are high enough to attract investment in transmission but not so high that they become unfair to consumers by allowing excess returns. FERC revamped its return-on-equity policy in 2014 by modifying its formula for computing those returns and now faces a slate of litigation across the country over how to implement the new policy.

Transmission Cost Allocation. FERC also will address a remand from the 7th Circuit that, for a second time, found that FERC had not supported its decision to allocate transmission costs broadly across the multistate PJM footprint, rather than only to customers benefiting from the transmission. How FERC handles this remand will affect other regions as well, particularly those with substantial opposition to spreading the costs of transmission across all customers.

Enforcement. FERC continues to aggressively implement its enforcement authority. However, its processes for enforcing its regulations and the substantive standards for doing so are the subjects of substantial debate in the industry, academia and Congress. Two pending federal district court actions are expected to decide key challenges to FERC's enforcement policies, including its market manipulation standard and the scope of district court review of penalty assessments. It is also possible that congressional oversight hearings will be held on whether FERC should reform some of its processes for prosecuting enforcement investigations.