Remarks on the Limits of the Federal Energy Regulatory Commission's Authority

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Annual Meeting, Mid-Atlantic Conference of Regulatory Utility Commissioners

June 25, 2024

The following remarks were prepared for delivery at a debate between Travis Kavulla[1] and James Danly,[2] on the question: "Resolved: FERC may not make nationwide electricity policy through its ratemaking authority." Mr. Kavulla took the negative position, as expressed and qualified below. The debate was held at a general session of the Mid-Atlantic Conference of Regulatory Utility Commissioners, held at their annual meeting in Louisville, Kentucky.

FERC regulates a network industry where the commodity that transits it moves at the speed of light and everywhere is heedless to state boundaries—except where literal physical impediments exist, as in Texas, Alaska, and Hawaii. But for these states, electricity is characteristically interstate in nature. It would be strange to conclude that the physics or economics of the grid are so radically different from place to place so as *never* to brook the possibility that a uniform regulation would be appropriate.

I think I have an easy win in this debate, to be honest, because there are clearly policies that are appropriate for FERC to adopt in a nationwide fashion. And even James agrees! As he wrote in his concurring opinion to Order 2023, addressing the interconnection process, that he was "satisfied based on the record that existing interconnection procedures in both RTO and non-RTO regions have been shown to be unjust and unreasonable" and that "the relatively narrow reforms contemplated in this final rule appear, based on this record, to be a just and reasonable replacement rate."[3] Now, it is necessary to say that Commissioner Danly then qualified these statements by saying he wished that courts would not let him get away with things like this, that the existing legal precedents that let him make nationwide policy might ultimately be invalidated, and that rather than a single case, he would rather be dealing with literally dozens if not hundreds of individual utility filings to consider the same issues.

I confess, I admire a regulator who wants to be trammeled by the niceties of the law. It must be the Catholic in us, James. It's sort of like the saints of old, mortifying their bodies to make themselves holy. But I don't think the canon of the Federal Power Act requires this, I do not think it promotes efficiency, and more importantly courts have said as much.

Since James and I agree on what the case law has to say, I will not belabor it, other than to note FERC has been at the very least 40 years in the business of collecting evidence about the

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[3] *Improvements to Generator Interconnection Procedures and Agreements*, 184 FERC ¶ 61,054. Concurring Opinion of Commissioner James Danly, PP 1-2.

characteristics of its regulated industries at large, in order to remedy problems with them in generic proceedings.

In doing so, it has promoted the interests of consumers, including by ensuring that consumers and the gas utilities that serve them are not captive to long-term tie-ups of natural gas together with pipeline capacity. When FERC liberalized that market and unbundled pipeline services in Orders 436 and 636—work it began a full decade before electricity industry restructuring—it did so by issuing orders that generically applied to all the interstate pipelines it regulated. It was able to do this because, unsurprisingly, the monopolists were everywhere acting in a similar fashion. And in two cases, *American Public Gas Association* and *Wisconsin Gas*, appellate courts found that either rulemakings or adjudications can be used to make findings about rates, and that there was no need to have findings for each and every pipeline, but that evidence about how the structuring in general of the industry would lead to "undue discrimination" was sufficient to adopt the regulation in question.

FERC's electricity restructuring orders followed this same logic. In Order 888, requiring open access to the interstate electricity network in 1996, FERC relied upon the identical statutory provision in the Federal Power Act to the Natural Gas Act to adopt a rule that relied on its power to investigate whether rates were "unduly discriminatory." Citing *Wisconsin Gas,* the U.S. Circuit Court for the District of Columbia found it acceptable in affirming the Commission (*Transmission Access Policy Study Group v. FERC*), that the agency had "relied upon general findings of systemic monopoly conditions and the resulting potential for anti-competitive behavior, rather than evidence of monopoly and undue discrimination on the part of individual utilities."

So has a lineage of cases been built since then, including Order 2000, Order 890, Order 1000, Order 2222, Order 2023, and most recently again in Order 1920 on transmission planning and cost allocation. I don't think any of these should be ruled unlawful because they exercise nationwide authority, but Order 1920 may end up becoming an example of why, even if a regulator can exercise its authority nationally, it should be prudent in doing so.

First, the things FERC is requiring utilities to do in Order 1920 are a multitude, and compliance with them will take years of work. Even though Order 888 had grander effects, compliance was more straightforward because it was uniform. Order 1920 still remains to a significant extent a choose-your-own-adventure novel, albeit subject to a FERC rulebook that is now as complex as Dungeons and Dragons. Indeed, if Order 1000 compliance was any indicator, the regulatory compliance workload consumed the time of the very personnel at utilities that would otherwise be…actually planning for transmission! Meanwhile, the fact that many of the individual distinctions of utilities and markets will be worked out through the compliance-filing process suggests that whatever boldness the rule portends may not be realized soon, or perhaps ever. It depends entirely on the long tail of regulation that follows this Order.

Second, as to the threat to the rule's legality, let's consider FERC's posture in this matter. FERC is essentially determining that transmission rates are "unjust and unreasonable"—because they are too low! That is to say, FERC's order rests on the assumption that it believes transmission is

being underinvested in, relative to the benefits they provide to things, such as retail energy supply or corporate goals, that FERC itself does not regulate. Sure, FERC has a big record here—but the agency hardly goes through the effort of any kind of robust economic analysis to justify its economic findings. It's interesting: When EPA wants to do something, however disagreeable, they do their own in-house modeling work; when FERC wants to do something, it expects a report from So-and-So and then concludes that So-and-So is a pretty substantial guy as far as evidence is concerned.

Anyways, FERC Order 1920 is at quite a different posture than, say, Order 888, which at its core was a finding about how an industry restructuring was necessary because to let it go on otherwise would result in "unduly discriminatory" rates. To me, undue discrimination is the most readily articulable finding FERC can likely make with a generic record, because it hews closely to questions of how the industry at large is structured. Meanwhile, whether rates are just and reasonable seems to have a more numerical bearing. Yet that is where FERC lays its cards; indeed, for all 1,300 pages, there are not more than a few sentences of FERC's reasoning that specifically attach to the question of "undue discrimination"—even though this, arguably, is what is at hand when utilities prefer local and supplemental projects over regional projects.

Things are also awkward in Order 1920 because, when presented with a variety of proposals that are more closely tied to ratemaking conventions, FERC demurred. In the NOPR leading to Order 1920, FERC had proposed abolishing the recovery in rates of Construction Work In Progress ("CWIP"). This clearly would have had a ratepayer impact—a positive one—but FERC abandoned it in the final rule. It also rejected various proposals, including NRG's, to tighten up ratemaking associated with local and supplemental project spending, which funnels almost immediately into the rates consumers pay through formula ratemaking. As this audience well knows, the regulation (or one could say the absence of regulation) that governs this space ends up driving capital to low-risk parochial opportunities, likely at the expense of regional and inter-regional projects.

So one must ask: How did the regulator come to have such strong opinions that the rates are unjust and unreasonable, when it has been nothing if not a timid body when it comes to the active regulation of those transmission rates to begin with? As Prof Paul Joskow has recently noted about the kind of ratemaking FERC administers, "formula rates are basically automatic, pure cost-of-service-regulation plans that have extremely poor incentive properties."[4] Or to the degree any incentives do ride atop this pass-through form of regulation, it is just a bonus return, or "FERC candy," as Commissioner Christie has often said.

All told, what Order 1920 itself and its context suggests is that FERC is moving away from being an economic regulator in this space, employing prices as an incentive for the purposes of policy, and is instead becoming an agency acting through central planning edicts. But it should exercise prudence and caution, because it is only able to do what it does in transmission planning at all in the name of its authority regarding rates and economic regulation. Some court eventually will

[4] Paul Joskow, "The Expansion of Incentive (Performance Based) Regulation of Electricity Distribution and Transmission in the United States," (Jan. 2024) at 28. https://ceepr.mit.edu/wp-content/uploads/2024/01/MIT-CEEPR-WP-2024-01.pdf

recognize that the game FERC is now playing wasn't the one it was playing when it first laid claim, and was affirmed to have, its generic, nationwide authority.

So while I'm a critic of Order 1920's vibe, I don't contest that there is some kind of transmission rule that should be promulgated nationwide in order to remedy what ails the industry at present. Thus I am obliged to negate the resolution, because were it affirmed, I can certainly see the outcome clearly: Utilities would use their individuated filing rights to speed up things in their interest, and slow down everything else, further balkanizing the landscape in the process. What the industry needs more of—and this is a lesson for state regulators too—is a consistency across the industry needed to produce the innovations and efficiencies that have been present in other network industries. I do not see how you get there in affirming the resolution.