DOE DIRECTS FERC TO ISSUE GRID RESILIENCY RULES PROVIDING COST RECOVERY FOR TRADITIONAL BASELOAD GENERATION

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Power Alert

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On September 28, 2017, using the Secretary of Energy's authority under Section 403 of the Department of Energy Organization Act, the Department of Energy ("DOE") proposed a rule for final action by the Federal Energy Regulatory Commission ("FERC"). The rule would allow certain traditional baseload generators, such as coal and nuclear plants, to "fully recover costs" to maintain the reliability and resiliency of the electric grid. DOE is requiring FERC to consider and take final action on the proposed rule within 60 days after publication in the Federal Register. In the alternative, Secretary of Energy Rick Perry urges FERC to issue the proposed rule as an interim final rule, effective immediately. The proposed rule has the potential to have a significant impact on wholesale electricity markets, implicate a host of issues related to the pricing of electricity, and draw strong objections from the oil and gas industry, environmentalists and wind and solar generators. FERC has docketed the proposed rule at RM17-3-000.

DOE'S PROPOSAL

The proposed rule directs FERC to issue a final rule requiring regional transmission organizations ("RTOs") and independent system operators ("ISOs") to develop and implement market rules that "accurately price generation resources necessary to maintain the reliability and resiliency of our Nation's bulk power system." The rule would specifically require ISOs and RTOs to establish "just and reasonable rate tariffs" for the recovery of costs and a fair rate of return for "fuel-secure generation units" within FERC-approved organized markets. Units eligible for cost recovery must be able to provide essential energy and ancillary reliability services and have a 90-day fuel supply on site. Eligible units must also comply with all applicable environmental regulations and not be subject to state cost-of-service rate regulation.

In support of the proposed rule, DOE asserts that the resiliency of the electric grid is being threatened by the premature retirements of "fuel-secure traditional baseload resources." Citing the effects of weather phenomena such as the 2014 Polar Vortex and recent hurricanes, DOE argues in favor of greater protection for baseload resources, such as coal and nuclear, that have essential reliability and resiliency attributes, including on-site fuel supplies and the ability to provide voltage support, frequency services, operating reserves, and electric power. According to DOE, market forces have led to significant retirements of traditional baseload generation, an effect Secretary Perry claims has resulted from the failure of RTO and ISO markets to pay these generators for all of the attributes they provide to the grid, including resiliency. Thus, Secretary Perry states in a letter accompanying the proposed rule that FERC must ensure that "the reliability and resiliency attributes of generation with on-site fuel supplies are fully valued," and FERC must immediately exercise its authority to develop new market rules that achieve this objective.

INDUSTRY IMPACT

Industry experts have indicated that the proposed rule could bring the most significant changes to wholesale electricity markets in the last decade. If implemented, the proposed rule could upend the organized energy markets. DOE proposes that the rule would only apply to generating units currently authorized to sell power at prices set by competitive wholesale power markets. These markets generally set prices based on competitive sell offers at numerous pricing nodes, a system known as "locational marginal pricing" or "LMP." However, by requiring that covered generators be compensated under "just and reasonable rate tariffs" that allow for the recovery of costs and a fair rate of return, implementing DOE's directive would require FERC to effectively re-regulate all coal and nuclear generation units and develop an alternate pricing system to account for these re-regulated units in the competitive wholesale market structure. This would present significant implementation challenges. While there are several ongoing FERC proceedings in which FERC has received comments on price formation, coal and nuclear retirements, and pricing to ensure reliability and resiliency, developing a structure or pricing model that works in each of the organized markets affected by the proposed rule will likely require fundamental changes to existing market mechanics.

Given the current controversy surrounding the issue at FERC and in the states, the proposed rule will likely face significant stakeholder opposition. Environmentalists are likely to argue that FERC cannot adopt a final rule without preparing an Environmental Impact Statement ("EIS") (notwithstanding that FERC actions taken pursuant to Sections 205 and 206 of the Federal Power Act are exempt from EIS requirements). The oil and gas industry, as well as solar and wind generators, are also likely to make strong objections.

Notably, the proposed rule appears designed to achieve the same goals as state programs designed to support nuclear generation through zero-emission credit ("ZEC") programs. While these programs have survived recent challenges in federal court, industry stakeholders continue to oppose ZECs as unconstitutionally distorting outcomes in FERC-regulated markets.

FERC'S ACTION PLAN

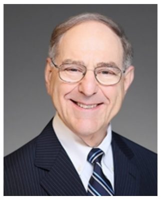
DOE issued the proposed rule pursuant to its authority under Section 403 of the DOE Organization Act. The proposed rule invites FERC to issue a notice for comment within two days of the notice's publication in the Federal Register. If FERC does not do so, the proposed rule provides that interested parties will have 45 days from publication in the Federal Register to provide comments. The proposed rule requires FERC to act on the proposal within 60 days of publication in the Federal Register.

Section 403 may, however, provide FERC some flexibility in how quickly it must act. Specifically, Section 403(b) requires FERC to take final action on any proposal made by the Secretary in accordance with "reasonable" time limits set by the Secretary. Section 403(c) further provides that the procedures in such rulemaking proceedings "shall assure full consideration of the issues and an opportunity for interested persons to present their views." Given the seismic impact the proposed rule could have on the operation of all wholesale electric markets under

FERC's jurisdiction, FERC may determine that additional time to issue a final rule is necessary to give full consideration to the proposed rule's effects and to give stakeholders a reasonable amount of time to comment.

The proposed rule has not yet been published in the Federal Register. K&L Gates' energy attorneys are continuing to monitor the situation, so please stay tuned for important updates on FERC's plan of action to address the proposed rule.

KEY CONTACTS



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