

E-ALERT | Clean Energy and Climate

July 29, 2010

FERC ISSUES PRECEDENTIAL RULING ON CALIFORNIA'S FEED-IN TARIFF AND FERC STAFF PRESENTS SMART GRID PROCESS RECOMMENDATIONS

The FERC recently issued an order ruling for the first time on FERC's role in connection with a state approved feed-in tariff and identifying conditions under which California's feed-in tariff would not be preempted by federal laws governing wholesale electricity sales in interstate commerce. In addition, FERC Staff recently presented process recommendations for adopting smart grid interoperability standards.

CALIFORNIA FEED-IN TARIFFS

Feed-in-tariffs essentially involve a long-term guaranteed level of income for electricity produced by small-scale renewable energy systems, usually above market prices for electricity, to promote renewable energy technology and reduce greenhouse gas emissions. California and Vermont have established feed-in-tariffs and a number of other states have initiated or announced plans for feed-in tariffs.

In a highly anticipated and precedential order addressing a California Public Utility Commission (CPUC) feed-in tariff that requires utilities to purchase power from certain generators at a specific price, FERC on July 15 made two important clarifications regarding limitations on state authority regarding feed-in tariffs. First, FERC found that the CPUC program is preempted by the Federal Power Act (FPA). FERC noted that the FPA gives FERC exclusive jurisdiction to regulate rates for sales for resale in interstate commerce and accordingly found the CPUC's decisions constitute impermissible wholesale rate-setting. And second, FERC said that the CPUC program would not be preempted if: (1) the generators are Qualifying Facilities (QFs) under PURPA, and (2) the purchase rate does not exceed the avoided cost of the purchasing utility. [Docket Nos. EL10-64 and EL10-66]

This is the first time FERC has addressed feed-in tariffs, and it has been reported that Chairman Wellinghoff said that this order represents precedential thinking on how, in the context of PURPA, FERC will rule on feed-in tariff disputes.

While signaling to states how feed-in tariffs can be structured consistent with Federal law, FERC's order also places limitations on state programs by limiting them to QFs. For example:

- Purchase rates are restricted to the purchasing utility's "avoided costs," thereby limiting incentives that may be included in those rates.
- Renewable resources (and all "small power production" facilities under PURPA) must be no larger than 80 MW to qualify as a QF, thereby excluding large wind and solar projects from state feed-in tariff programs.

Some utilities have received exemptions from purchase obligations under PURPA. Under certain conditions, such as membership in RTOs or ISOs, there is a rebuttable presumption that utilities have no obligation to purchase from QFs larger than 20 MW.

Background

A California statute requires investor-owned utilities regulated by the CPUC to offer to purchase, at a price set by the CPUC, electricity that is generated by combined heat and power (CHP) generators that are not larger than 20 MW and meet certain efficiency and emissions standards. The utilities must file standard ten-year purchase contracts (feed-in tariffs) with the CPUC. The CPUC issued an order implementing the purchase requirement.

The CPUC petitioned FERC to find that the FPA, PURPA and Commission regulations do not preempt the CPUC's program implementing the purchase requirement. The CPUC did not dispute that the Commission has exclusive authority over rates for wholesale sales under the FPA but argued that it has only required that utilities offer to purchase but does not require a generator to sell. The CPUC said the purpose of the program is environmental protection, particularly the reduction of greenhouse gases.

California's investor-owned utilities, in a separate petition, argued in opposition that the CPUC program is preempted by the FPA, which gives FERC exclusive authority over wholesale power sales. The utilities contended that because the mandatory offer cannot be withdrawn without CPUC direction, the offer is a requirement to purchase at the price established by the CPUC and thus the CPUC is regulating the price of wholesale energy sold by CHP generators.

FERC's Decision

FERC found that the CPUC's decisions constitute impermissible wholesale rate-setting and are preempted by the FPA. The order noted that the Commission's authority under the FPA includes exclusive jurisdiction to regulate the rates, terms and conditions of sales for resale of electric energy in interstate commerce by public utilities. The order also observed that, other than in PURPA, Congress has not authorized opportunities for states to set rates for wholesale sales in interstate commerce by public utilities. FERC said it appreciated that the CPUC's program is intended to reduce greenhouse gas emissions but arguments concerning the environmental considerations underlying the feed-in tariff program "do not excuse the Commission of its statutory obligations."

FERC found, however, that the CPUC's program may be acceptable under certain conditions. Pursuant to PURPA, states may require utilities to purchase from QFs but not at rates that exceed the utility's avoided cost. And state commissions may determine the avoided cost rates. Accordingly, FERC found that insofar as the generators that can take part in the CPUC's program are QFs, the CPUC's program is *not* preempted as long as: (1) the generators from which the CPUC is requiring the utilities to purchase energy and capacity are QFs pursuant to PURPA; and (2) the rate established by the CPUC does not exceed the avoided cost of the purchasing utility. It should be noted that, according to the CPUC, most, if not all, CHP generators, could obtain QF status.

FERC provided the following additional clarifications:

- Any generator that is not a QF but is a public utility must file its proposed rates with FERC for approval. To the extent a CHP generator is *not* a QF, the CPUC's decisions are not preempted by the FPA only to the extent that the CPUC is ordering the utilities to purchase capacity and energy from certain resources, but are preempted to the extent that the CPUC is setting wholesale rates for such transactions.
- Sales from public agency sellers (e.g., states or their subdivisions, agencies, authorities, or instrumentalities) that are exempt from FERC jurisdiction are not preempted because those facilities are neither QFs nor public utilities and thus their rates are not subject to FERC regulation. Such rates are accordingly not preempted by the FPA.

- FERC's jurisdiction is implicated for distribution-level facilities and distribution-level feed-in tariffs. The Commission's authority to regulate sales for resale of electric energy and transmission in interstate commerce is not dependent on the location of generation or transmission facilities, but rather, as relevant in this case, the definition of wholesale sales contained in the FPA.

Parties almost certainly will seek rehearing and appeal of FERC's ruling. In the meantime, market participants and states seeking guidance on how to craft feed-in-tariffs that do not run afoul of federal law as interpreted by FERC should review this order carefully.

The FERC order is available [here](#).

SMART GRID STANDARDS PROCESS

The Energy Independence and Security Act of 2007 (EISA) directed the National Institute of Standards and Technology (NIST) to coordinate the development of standards for smart grid devices to achieve interoperability. EISA also directed FERC to adopt standards to insure smart-grid functionality and interoperability in interstate transmission of electric power, and regional and wholesale electricity markets. FERC is to do so through a rulemaking once it is satisfied that NIST's work has led to "sufficient consensus."

At FERC's recent public meeting, Staff said that when NIST's smart grid standards are ready for FERC's consideration, NIST will post them on its website and inform FERC by letter. Staff said that it expects the first group of smart grid standards may be available from NIST for FERC's consideration by late summer, and they may include emerging technology standards that impact transmission and distribution level facilities.

FERC staff made the following recommendations to the Commission for processing smart grid standards:

Periodically initiate rulemakings on new smart grid interoperability standards posted by NIST. Staff anticipates a continuing development of standards.

Rulemakings should propose to adopt all standards identified by NIST as ready for FERC's consideration.

Rulemakings should use the following criteria to evaluate proposed standards:

- Whether sufficient consensus was reached
- Whether the standard is needed for smart grid functionality and interoperability in interstate transmission of electric power and regional and wholesale electricity markets
- Whether there are known cyber security issues

With respect to whether a standard is needed, rely on reports and documents prepared by NIST, FERC staff has worked with NIST staff to ensure these documents will provide the information needed by FERC's rulemaking process. NIST's documents will be posted on its public website.

With respect to cyber security risks, look to the rulemaking comments and to the work of NIST's Cyber Security Working Group (CSWG). The CSWG is composed of security professionals from federal and state agencies, private security firms, and the information technology, communications and power industries. The CSWG will soon issue a report on the cyber security needs for the smart grid and will use the report's requirements to analyze individual standards. Staff observed that NERC, the power industry's reliability watchdog, will play an important role with respect to cyber security.

As the standards development process continues to evolve, FERC staff may recommend additional or revised processes.

FERC staff's presentation is available [here](#).

Background Material

In July 2009, FERC issued a smart grid policy statement that identified issues and smart grid functionalities that deserved priority in the standard setting process. Two cross cutting issues were identified: system security and inter-system communication. Four key functionalities were identified: wide-area situational awareness, demand response, electric storage and electric vehicles. Commission staff reports that NIST has accepted these priorities and added two more: advanced metering and distribution system automation.

A Covington e-alert summarizing FERC's July 24, 2009 smart grid policy statement is available [here](#).

NIST in January 2010 issued a *Framework and Roadmap for Smart Grid Interoperability Standards*. NIST's framework identified 75 interoperability standards applicable to developing smart grid technologies and applications. It also described action plans for addressing gaps in smart grid standards needed to fulfill NIST and FERC priorities.

NIST's January 2010 publication is available [here](#).

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