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Each bimonthly issue of the *Washington Energy Update* highlights useful energy regulatory tips and a wide range of issues impacting the energy markets.

If you have any questions or would like more information about anything appearing in this issue, please contact the editors or your White & Case relationship lawyer. Please let the editors know if you would like a particular topic covered in a future issue or have suggestions on how this newsletter can be improved.

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Energy Highlights

- On March 11, 2013, the Nuclear Regulatory Commission (NRC) denied a petition for review of its finding that UniStar Nuclear Operating Services, LLC and Calvert Cliffs 3 Nuclear Project, LLC are ineligible to obtain a license to construct and operate a new reactor at the existing Calvert Cliffs site due to their 100% ownership by a foreign corporation. However, the NRC directed its staff to review its policy on foreign ownership and consider whether additional guidance on ownership is necessary.
- On March 15, 2013, the DC Circuit Court of Appeals granted a petition for review of the US\$30 million penalty FERC assessed against Brian Hunter for manipulation of the natural gas futures market that resulted in alleged harm to the physical gas markets. The court concluded that FERC lacked authority to penalize manipulation of natural gas futures contracts because such activity falls within the CFTC's exclusive jurisdiction under the Commodity Exchange Act.

Just the Facts: FERC Dismisses Third-Party Complaint of Alleged Reliability Standards Violations Due to an Insufficient Evidentiary Record

Caileen Gamache

On March 4, 2013, FERC dismissed a complaint filed by PacifiCorp alleging that the Los Angeles Department of Water and Power (LADWP) and the Western Electricity Coordinating Council (WECC) (in both its capacity as a Reliability Coordinator and Regional Entity) violated certain mandatory Reliability Standards of the North American Electric Reliability Corporation (NERC), referring the matter to NERC for further investigation.¹ FERC's dismissal, however, was based on the lack of sufficient evidence put forth by PacifiCorp in support of its complaint, rather than the appropriateness of the complaint as a procedural vehicle for addressing alleged third-party violations of the Reliability Standards. FERC's decision keeps the window open for aggrieved parties to bring alleged violations for redress either directly to FERC or to the NERC Regional Entities in the future.

¹ *PacifiCorp v. WECC*, 142 FERC ¶ 61,172 (2013) ("Order").

PacifiCorp's complaint alleged that LADWP violated Reliability Standards by failing to follow WECC's Path Rating Process for certain transmission lines in the vicinity of PacifiCorp's transmission lines. The violation purportedly caused PacifiCorp harm because it was forced to implement curtailments to compensate for the additional flow caused by LADWP's violations to ensure reliability of the grid. PacifiCorp also alleged that WECC violated the Reliability Standards by acquiescing to LADWP's violations. The complaint stemmed from an ongoing dispute between LADWP and PacifiCorp regarding the operation of their respective neighboring transmission lines located within the Western Interconnection. LADWP submitted aspects of the dispute to WECC's dispute resolution procedures, which were ongoing at the time the complaint was filed. Aspects of the dispute were also the subject of a prior FERC proceeding in which FERC found that PacifiCorp could not charge LADWP unreserved use penalties during curtailment periods because LADWP's actions did not constitute "unreserved use" under PacifiCorp's Tariff.² PacifiCorp alleged LADWP violated certain Reliability Standards in its response in the prior proceeding as well. FERC concluded, however, that the alleged Reliability Standards violations were "beyond the scope of [that] proceeding."³ PacifiCorp explained that it brought the instant complaint "[t]o ensure that the Reliability Standards violations committed by LADWP—and by WECC—are squarely in front of the Commission."⁴

Both LADWP and WECC asked FERC to dismiss PacifiCorp's complaint. LADWP stated, "PacifiCorp's Complaint prematurely and inappropriately invokes [Federal Power Act ("FPA")] Section 215(e)(3) as a way for the Commission to step into the middle of this ongoing and longstanding dispute."⁵ LADWP further argued that:

PacifiCorp's request that the Commission directly investigate and rule on fact-specific, technical reliability issues attempts to circumvent the primary means set forth by Congress for addressing potential violations of reliability standards in the first instance: through NERC and regional entities such as WECC. As discussed below, FPA Section 215(e)(3) was not intended to be a primary means for addressing specific, technical compliance with reliability standards and utility-versus-utility path rating disputes, and the Commission should resist

PacifiCorp's invitation to use its discretionary authority over reliability enforcement to directly investigate PacifiCorp's allegations under the circumstances presented.⁶

WECC similarly argued that it would be inappropriate for FERC to rule on the purported Reliability Standards violations. WECC stated that even if PacifiCorp's allegations were true, "the Complaint attempts to avoid longstanding Commission practice to allow the Electric Reliability Organization (ERO) and Regional Entities to attempt to resolve disputes between utilities and concerning alleged violations of Reliability Standards before filing with FERC. Thus, the Commission should decline to exercise its discretionary authority over the matters addressed in PacifiCorp's Complaint."⁷

FERC ultimately dismissed the complaint, without prejudice, and referred the matter to NERC to investigate. FERC granted NERC discretion to determine the scope of the investigation, and also stated that NERC may enlist the assistance of the Northeast Power Coordinating Council (NPCC), WECC's Compliance Enforcement Authority, for the investigation of WECC's alleged violations.⁸ FERC explained that, contrary to LADWP's and WECC's requests, WECC is in fact precluded from participating in an investigation of the matter because the allegations implicate its activities as both a Regional Entity and a Reliability Coordinator.

Notably, FERC did not agree with WECC and LADWP that it would be inappropriate or contrary to congressional intent or prior FERC practice for it to rule on the merits of the complaint if sufficient evidence was provided. FERC even reiterated its authority under Section 215(e)(3) of the Federal Power Act to investigate directly alleged Reliability Standards violations and order compliance and penalties. Instead, the order was based on FERC's finding that the "existing record in this docket is insufficient to allow us to reach a determination on the merits of PacifiCorp's allegations."⁹ As one example, FERC explained that none of the parties provided FERC a "complete and detailed timeline of the events," which is necessary to determine if the cited Reliability Standards were even enforceable at the time of the alleged violations.

The order leaves open the possibility that, given a more robust record or less data-intensive violation, FERC might rule directly on the merits of a third-party complaint regarding Reliability Standards violations in the future.

² *LADWP v. PacifiCorp*, 141 FERC ¶ 61,112 (2012).

³ *Id.* at P 42.

⁴ *PacifiCorp v. WECC*, Docket No. EL13-22-000, at p. 3 (filed Nov. 16, 2012).

⁵ *PacifiCorp v. WECC*, Docket No. EL13-22-000, at p. 2 (filed Dec. 17, 2012) (LADWP's Motion to Dismiss and Answer).

⁶ *Id.* at pp. 2-3.

⁷ *PacifiCorp v. WECC*, Docket No. EL13-22-000, at p. 2 (filed Dec. 17, 2012) (WECC's Motion to Dismiss and Answer).

⁸ NPCC has the authority to conduct compliance investigations of WECC's function as a Registered Entity. It does not have authority to investigate Registered Entities within the WECC region and therefore does not have jurisdiction over LADWP. See *North American Electric Reliability Corp.*, Docket No. RR11-2-000 (Nov. 13, 2011) (delegated letter order).

⁹ Order at P 27.

FERC Holds a Firm Line on Mitigation Plans, Denying Approval Under FPA Section 203

Jane Rueger

On March 7, 2013, FERC took the unusual step of denying an application under Section 203 of the Federal Power Act for authorization to sell a large gas-fired generating facility in Arizona. FERC concluded that the applicants' proposed plan to mitigate multiple, "large" screen failures was insufficient to allay market concentration concerns in the Arizona Public Service Company (APS) balancing authority area arising from the transaction. The order reflects FERC's continued rigorous review of proposed mitigation plans, particularly for transactions occurring outside of an RTO or ISO, and requirement that such mitigation plans that propose less than full divestiture of generation provide meaningful restrictions on applicants' decision-making discretion and control over generation.

MACH Gen, LLC (MACH Gen) proposed to sell all of its outstanding membership interests in its wholly owned subsidiary, New Harquahala Generating Company, LLC (New Harquahala), to Saddle Mountain Power, LLC (Saddle Mountain). New Harquahala owns the 1,054 MW Harquahala generating facility (Harquahala Facility) located in the APS balancing authority area. Due to Saddle Mountain's affiliation with several other generation projects in the APS balancing authority area, including two units of the Gila River gas-fired facility (Gila River Facility), the proposed transaction resulted in a failure of FERC's screens for horizontal market power in seven out of the ten periods studied under both the Available Economic Capacity and Economic Capacity measures. In an attempt to address these screen failures, the applicants proposed that New Harquahala would enter into an Energy Management Agreement (EMA) with an unaffiliated third party, Twin Eagle Resource Management, LLC (Twin Eagle). The applicants stated that Twin Eagle would be given dispatch authority over the Harquahala Facility and discretion to engage in short-term sales of energy and capacity from the facility. In addition, the applicants asserted that New Harquahala would only receive summary revenue and expenses information and forward commitment reports from Twin Eagle and would not be provided material, nonpublic information regarding sales and dispatch of the Harquahala Facility. However, New Harquahala would establish the facility's operating limits, dispatch and efficiency curves and operating costs, and would also retain authority to enter into long-term transactions for the facility's energy and capacity.

While the application was unopposed, FERC nonetheless held that the applicants failed to demonstrate that the proposed transaction would not have an adverse effect on competition in the APS balancing authority area and denied the application. In reaching this conclusion, FERC considered "the totality of the circumstances"

surrounding the proposed mitigation plan and concluded that the proposed EMA would not convey "unlimited discretion and control" to Twin Eagle and therefore did not adequately mitigate FERC's competitive concerns. In particular, FERC highlighted its concern that New Harquahala retained authority to dictate the inputs to the Harquahala Facility's dispatch model used by Twin Eagle under the EMA. Noting that the Gila River Facility uses similar generation technology to the Harquahala Facility, and therefore would be expected to have similar dispatch cost and availability to the Harquahala Facility, FERC concluded that New Harquahala and its affiliates would have "access to one type of relevant information to which no other market participant will have, namely, advance knowledge of the short-term marketing strategy of the generation output of the Harquahala Facility." FERC found that New Harquahala's affiliates that control the Gila River Facility would presumably have access to this information about the Harquahala Facility and could unilaterally withhold output from the Gila River Facility or raise prices in the APS balancing authority area. FERC also found that New Harquahala's ability to engage in long-term transactions from the Harquahala Facility was "at odds with" the applicants' claim that control over the Harquahala Facility should not be attributed to New Harquahala and its affiliates: "[i]f the facility can still be marketed for sales by New Harquahala, then it is still under New Harquahala's control to some degree and should properly be attributed to New Harquahala." FERC denied the application, rather than approving it subject to a compliance filing with a new mitigation proposal as it has done in other cases, because it found that the screen failures were not temporary; however, the denial was without prejudice to the applicants filing a new application with strengthened mitigation measures.

This decision is notable for those considering mergers or acquisitions in the energy industry, particularly transactions involving generating capacity located outside of an RTO or ISO, because it signals that FERC will not rubber-stamp proposed mitigation plans, even where a proposed transaction is not opposed by any intervenor. FERC analyzed the details of the proposed EMA and registered its discomfort with the control New Harquahala retained over inputs to Twin Eagle's dispatch decisions, particularly in light of the similar technology and dispatch costs of affiliated generation. Notably, in this case FERC also remained troubled by the applicants' control over long-term transactions from the Harquahala Facility, even though FERC has generally found that long-term capacity markets are competitive. Virtual divestitures must convey "unlimited discretion and control" away from an applicant and its affiliates, and this order—like the 2011 order initially rejecting proposed mitigation measures for the merger between Duke Energy Corporation and Progress Energy, Inc.—shows that FERC will thoroughly analyze the details of a proposed mitigation plan to confirm that mitigation is not illusory.

President's Second-Term Energy Opener: An 'Energy Security Trust'

Patrick Holten

On March 15, 2013, President Obama traveled to Chicago's Argonne National Laboratory to deliver the first major address on energy policy of his second term. In it, he outlined a proposal to create an "Energy Security Trust" that would fund research into cost-effective technologies aimed at energy-efficient transportation alternatives. The President said the program would spearhead technologies based on homegrown biofuels, fuel cells, electric vehicles and natural gas.

The proposal's larger goal, first revealed by the President in his State of the Union address, is to "shift our cars and trucks off oil for good." The 10-year initiative would be funded with US\$2 billion in money diverted from federal royalties collected on oil and gas drilling on the Outer Continental Shelf (OCS). Such a change would require Congressional approval.

In Congress, the proposal faces an uncertain future. Democrats are generally supportive, but Republican support is needed in both chambers for anything to pass. In the Senate, the top Republican on the Energy and Natural Resources Committee, Senator Lisa Murkowski (R-Alaska), was somewhat supportive, calling it "an idea I may agree with." Sen. Murkowski proposed a similar idea in an energy policy manifesto she released earlier this year. However, her proposal is tied to opening up large swaths of federal land and waters to energy development, including the Arctic National Wildlife Refuge, which most Democrats oppose for environmental reasons.

In the Republican-controlled House, the President's proposal faces a steep, uphill battle. Asked about the possibility of GOP support for the President's Energy Security Trust, the office of Speaker John Boehner (R-Ohio) said that domestic energy exploration must increase dramatically "for this proposal to even be plausible."

The idea for an Energy Security Trust is based on a proposal drawn up by a nonpartisan coalition of CEOs and retired generals and admirals. This group, called Securing America's Future Energy (SAFE), is headed by FedEx Chairman and CEO Fred Smith and retired Marine Corps General P.X. Kelley. SAFE also supports opening more federal areas to energy development.

In addition to the trust fund, the President told the Argonne audience that the Administration continues to advocate and pursue an all-of-the-above approach to energy development. He said the US remains committed to "producing more oil and gas here at home," including more biofuels, fuel-efficient vehicles, solar power and wind power.

A White House Fact Sheet issued in support of the President's remarks at Argonne explains that this all-of-the-above energy strategy includes the over-arching goal of doubling the country's renewable energy production by 2020. To get there, the Administration supports a permanent, refundable Production Tax Credit for renewables. As for traditional energy sources, the Administration plans wider use of natural gas, streamlining oil and gas drilling permits, continuing nuclear production and exporting nuclear technologies, and other measures.

The Administration may release additional details on the Energy Security Trust when the President issues its Fiscal Year 2014 budget submission to Congress on April 8, 2013. In the interim, information on the President's Energy Security Trust is posted at: <http://www.whitehouse.gov/the-press-office/2013/03/15/fact-sheet-president-obama-s-blueprint-clean-and-secure-energy-future>.