July 14, 2020

DC Circuit Court Decision on Federal/State Jurisdiction in Energy Storage

In a July 10 decision, in *National Association of Regulatory Utility Commissioners v. FERC* (*NARUC*), the U.S. Court of Appeals for the District of Columbia Circuit put down another marker on the boundary between federal and state jurisdiction of electricity market participation.[1] The Court held that the Federal Energy Regulatory Commission (FERC) has jurisdiction to prohibit states from barring local energy storage resources (ESRs) from participating in the wholesale markets, even when ESRs are connected behind the meter or are using state-regulated distribution facilities. Thus, *NARUC* provides more clarity in the continuing development and integration of ESRs into the wholesale markets and furthers efforts to establish boundaries between federal and state jurisdiction.

NARUC involved two petitions for review[2] of a FERC order on rehearing of its initial Order No. 841, which sought to eliminate barriers for ESR participation in wholesale markets and provide a participation model for ESRs in those markets.[3] In Order No. 841, the FERC explained that its definition of ESR is intended to include "all types of electric storage technologies, regardless of their size, storage medium..., or whether the resource is located on the interstate grid or on a [local] distribution system." In Order No. 841, the FERC rejected arguments that states have the authority to decide whether ESRs "in their state that are located behind a retail meter or on the distribution system are permitted to participate in the RTO/ISO [wholesale] markets through the [ESR] participation model."[4]

In Order No. 841-A on rehearing, the FERC determined that a state may not "broadly prohibit" ESRs from participating in regional transmission organization/independent system operator (RTO/ISO) markets, because to do so "would intrude on the Commission's jurisdiction by prohibiting all consumers from selling into the wholesale market."[5] The FERC further stated that “Order No. 841 does not modify [S]tates' authority to regulate the distribution system, including the terms of access, provided that they do not aim directly at the RTO/ISO markets."[6]

In challenging the FERC's orders, petitioners argued that the FERC (1) had exceeded its jurisdiction by barring States from broadly prohibiting local ESR participation in RTO/ISO markets and (2) had impinged upon State jurisdiction to regulate State matters.

The Court denied the petitions, analyzing them in two main parts: (1) whether the FERC practice at issue (FERC barring states from prohibiting ESRs from participation in the wholesale markets) directly affects wholesale markets and (2) whether the FERC's practice results in the FERC regulating state-regulated facilities.[7]

First, the court "swiftly" concluded that the FERC's barring of state prohibitions of ESR participation in wholesale markets directly affects those markets, because this "action is intentionally designed to increase wholesale competition, thereby reducing wholesale rates."[8]

Second, the Court concluded that nothing in the FERC practice regulates state jurisdictional distribution systems.[9] Instead, the practice is aimed directly at allowing all qualified ESRs to participate in the wholesale markets. Moreover, the Court concluded that even if the practice forecloses States and their regulated distribution companies from blocking ESR access to distribution facilities for wholesale market participation, that outcome is allowed under the Supremacy Clause of the Constitution and federal preemption law.[10]

Under such law, a State may not regulate or otherwise interfere in an area where federal law provides exclusive authority to the federal regulator. Thus, as the Court explained, "[a]ny State effort that aims directly at destroying FERC's jurisdiction by

'necessarily deal[ing] with matters which directly affect the ability of the [Commission] to regulate comprehensively and effectively' over that which it has exclusive jurisdiction 'invalidly invade[s] the federal agency's exclusive domain.'"[11]

While denying the petitions, the court noted that states could take other indirect actions that would not necessarily invade the exclusive jurisdiction of the FERC regarding ESRs. For example, states may prohibit local ESRs from "participating in the interstate and intrastate markets simultaneously, meaning States can force local ESRs to choose which market they wish to participate in."[12] Or States may impose safety and reliability requirements and establish and approve all requisite "permits, agreements, and other documentation necessary to participate in federal wholesale markets."[13] The Court recognized that while this decision applies to the general principle of jurisdiction over wholesale market participation, specific-instance litigation would follow as states seek to challenge the boundary line between federal and state jurisdiction: "States will be free to challenge the Orders as applied to their own state regulations or imposed conditions."[14]

In short, *NARUC* stands for the proposition that the FERC, in establishing wholesale market structures that include local state-sponsored resources, can bar States from interfering with those markets by prohibiting local resource participation. The case leaves open the likelihood of continuing litigation that explores the jurisdiction of States to regulate such resources.

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[1] *Nat'l Ass'n of Regulatory Util. Comm'rs v. FERC*, No. 19-1142 (D.C. Cir. July 10, 2020). The decision is found here.

[2] Two separate petitions for review were filed by the National Association of Regulatory Utility Commissioners and by the American Public Power Association, the National Rural Electric Cooperative Association, Edison Electric Institute and American Municipal Power, Inc. The court consolidated the petitions and decided them together.

[3] *Elec. Storage Participation in Mkts. Operated by Reg'l Transmission Orgs. & Indep. Sys. Operators*, Order No. 841, 162 FERC ¶ 61,127 at ¶¶ 2, 7 (Feb. 15, 2018). Order No. 841 is available by clicking here.

[4] *NARUC* at 7 (quoting Order No. 841 at ¶ 35).

[5] *Id.* (quoting *Elec. Storage Participation in Mkts. Operated by Reg'l Transmission Orgs. & Indep. Sys. Operators*, Order No. 841-A, 167 FERC ¶ 61,154 at ¶ 41 (May 16, 2019)).

[6] *Id*. at 8 (quoting Order No. 841-A at ¶ 48).

[7] The Court also rejected arguments that the Commission's order was inconsistent with precedent regarding States opting out of certain FERC wholesale market programs and was, therefore, "arbitrary and capricious." The Court concluded that the FERC had provided adequate explanation for the different treatment in this case. *Id*. at 17???-19.

[8] *Id*. at 12??-13.

[9] *Id*. at 13?-14.

[10] *Id*. at 14-15.

[11] *Id*. at 15 (quoting *N. Natural Gas Co. v. State Corp. Comm'n of Kan.*, 372 U.S. 84, 91??-92 (1963)).

[12] *Id*. at 16.

[13] *Id*.

[14] *Id*.

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