FERC Berkshire Hathaway Order May Jolt Electricity Market

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In December 2014, the Federal Energy Regulatory Commission took an unusual step when it decided to independently investigate the market power status of the Berkshire Hathaway Energy (BHE) entities. Over the past 18 months, FERC has investigated the BHE entities’ market power in the Western United States.

On June 9, 2016, FERC issued an order revoking the BHE entities’ market-based rate (MBR) authority within the PacifiCorp East (PACE), PacifiCorp West (PACW), Idaho Power (IPCO), and Northwestern Corporation (NWMT) balancing authorities, and affirmed that MBR transactions may not be undertaken within the Nevada Energy balancing authority (NEVP). Effectively, the BHE entities will transact at cost-based rates throughout most of the West, but retain their ability to sell at market-based rates into the California Independent System Operator balancing authority. While it is expected that the BHE entities will seek rehearing of the revocation order and/or reapply to FERC for MBR authority, those proceedings may take months — if not years — to complete.
Background on FERC’s MBR Program

The Federal Power Act (FPA) mandates that FERC approve the rate under which an entity makes sales for wholesale electricity in interstate commerce and find that rate to be “just and reasonable.” Prior to 1992, the commission used a cost-of-service-based system to review and approve the rates for the sale of electricity, as a cost-based rate was viewed as the best way to ensure consumer protection in light of the natural monopolistic nature of electricity generation. Under the filed-rate doctrine, once FERC has accepted the rate, the seller must adhere to the rate absent a waiver.

As competition began in the industry, FERC moved to a market-based rate (MBR) program. Under the MBR program, upon a determination that the selling entity lacked market power, or had adequately mitigated market power in the relevant markets, FERC approved a seller’s ability to sell electricity at market-based rates. Under the MBR program, a seller may enter into short- and long-term transactions at negotiated rates and then must file after-the-fact quarterly reports with FERC listing the details of the consummated transactions. Under the FPA, it is unlawful to engage in wholesale sales of electricity at a rate other than the one approved by FERC.

Over the past 25 years, a robust MBR program has developed at FERC such that most wholesale energy transactions are conducted pursuant to a seller’s MBR authority. Other than Enron in 2003, FERC has never issued such a broad-reaching MBR revocation order as the BHE revocation order. FERC’s decision to require the BHE entities to sell at cost-based rates throughout the West may have broad-reaching impacts for buyers and sellers of electricity, as well as investors that finance generation projects throughout the country.

Impact on BHE Power Purchase Agreements

Entities that are currently negotiating purchases of energy from a BHE facility in the West should be aware that the BHE entities do not currently have authority to offer power at market-based rates, nor is it clear if the BHE entities have an applicable FERC-approved cost-based rate on file that would authorize any new transactions. Power purchase agreements executed in BHE’s current status will likely need to be submitted to FERC for review, comment and ultimate approval. Buyers and investors should be aware that any price that is agreed to in the PPA may be subject to refund and challenge at FERC — either by the buyer, FERC itself or a ratepayer. While it could be possible to address the price risk through other contract terms, the revocation order has injected significant uncertainty into the viability of new PPAs with BHE as the seller.

Buyers that executed a PPA with BHE after Jan. 9, 2015, should be aware that the PPAs may be subject to litigation for prospective price revisions. FERC has ordered that BHE compute refunds for all sales made between Jan. 9, 2015, and April 9, 2016, and prospectively from June 9, 2016. Under FERC’s rules, refunds are computed as the delta between the market-based PPA price and the cost-justified rate, plus interest computed at the FERC rate (3.25 percent for sales prior to quarter 2, 2016 and 3.45 percent for sales after quarter 2, 2016).

While it is presumed that a market-based rate is less than a cost-justified rate, given the market power concerns expressed in the revocation order, it is possible that BHE could submit a cost-justified rate that exceeds the market-based rate. Buyers in this position should closely monitor BHE’s refund report and examine BHE’s proposed refund computations as well as any newly instituted proceeding by BHE to
establish a going-forward cost-based rate. Buyers may be due refunds from BHE and should be aware that FERC may order prospective price revision in the PPAs to match the ultimate cost-based rate approved for the facility.

Buyers that executed a long-term PPA with BHE before Jan. 9, 2015, face uncertainty for the future of their contracts. In a brief footnote, FERC attempted to sidestep these issues by stating that the revocation order does not affect contracts entered into before the refund effective date of Jan. 9, 2015. FERC did not address, however, the distinction between a contract that ended by its own terms prior to the refund effective date and a long-term contract with a period of years remaining in its term. For contracts that ended by their terms prior to Jan. 9, 2015, the FPA prevents retroactive refunds.

Nothing in the FPA explicitly prevents buyers with term contracts from seeking refunds for purchases made from BHE during the FERC-established refund period, even if the contract was executed prior to Jan. 9, 2015. Further, if FERC mandates prospective price revision to long-term PPAs executed after Jan. 9, 2015, nothing in the FPA prevents buyers that executed long-term PPAs prior to Jan. 9, 2015, from seeking this same relief. It is worth noting that even if a buyer may choose to forgo these potential remedies, consumers or ratepayers may be incentivized to litigate the issue if the long-term fixed-price PPAs are in excess of the BHE cost-justified rate.

**Broad Industry Impact**

Since the development of competition in generation, the long-term PPA was viewed as a static document that was immune from future price revisions. The BHE revocation order confronts that assumption and is an indication that FERC, under the leadership of Norman Bay, is critically examining the competitive landscape of the industry and will not shy away from enforcement. This order demonstrates that PPA prices may be subject to price revision if a seller's MBR authority is revoked after the contract term has begun, potentially disrupting the financial modeling that predicated the PPA. Parties entering into PPAs should be aware of the risk of potential price revisions — either increases or decreases — and may want to implement changes to their contract terms in order to account for this risk.

While it may be possible to rely on Mobile-Sierra protection provisions, which generally only permit contract revisions if the revision is mandated by the “public interest,” it is not certain that Mobile-Sierra can protect from price revisions due to a revocation of MBR authority. The U.S. Supreme Court’s recent decisions on the degree of protection afforded by the Mobile-Sierra doctrine, including both Morgan Stanley Capital Group v. Public Utilities District No. 1 of Snohomish County, 554 U.S. 527 (2008) and NRG Power Marketing Inc. v. Maine Public Utilities Commission, 558 U.S. 165 (2010), did not address a situation where the underlying MBR authority is revoked part way through the contract term.

If the Mobile-Sierra issue arises in the context of the PPAs for the BHE entities, the outcome will have broad-reaching impacts. Parties wishing to rely on the Mobile-Sierra protections to prevent prospective price revisions will find support in both Morgan Stanley and NRG Power Marketing, as well as the seminal case Federal Power Commission v. Sierra Public Power Company, 350 U.S. 348 (1956).

However, parties should be aware that in an ongoing FERC proceeding a FERC administrative law judge found that the nominal dollar impact of $259 million on a 10-year contract was sufficient to overcome the Mobile-Sierra presumption, even when spread over millions of ratepayers. Parties wishing to avoid the Mobile-Sierra standard of review for prospective changes will find support in cases adjudicating the legality of FERC’s MBR program. In recent Ninth Circuit decisions, the court has relied on FERC’s ex ante

Conclusion

By the time Enron’s MBR authority was revoked, the company was no longer a going concern. BHE will undoubtedly continue as a dominant market participant throughout the West, and FERC’s actions to resolve concerns about ongoing market obligations will likely have wide-reaching and long-lasting impacts on the field of electricity contracting. FERC’s decision to permit the BHE entities to sell into the CAISO balancing authority at market-based rates may have the unintended consequence of expediting development of the West-wide regional transmission organization as a way to mitigate the market power conclusions in areas outside of CAISO.

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