



# Constitutional Issues, Administrative Procedures, and Cost Allocation and Rate Design

Christopher N. Skey

June 27, 2017

CLARK HILL

ARIZONA | DELAWARE | ILLINOIS | MICHIGAN | NEW JERSEY | PENNSYLVANIA | WASHINGTON, DC | WEST VIRGINIA

---

# TOPICS

- **Constitutional Issues**
  - Federal v. State Regulation
- **Administrative Procedures**
  - Federal & State Schemes
  - Deference Issues
- **Cost Allocation & Rate Design**
  - Cost Causation Principles
  - Case Study -- An Illinois Example

---

# CONSTITUTIONAL LAW 101

- We take for granted the federal government's authority to regulate aspects of energy markets on a national level.
- We also take for granted the authority of each state to regulate other aspects of energy markets.
- But where does that authority come from?
  - Source of authority?
  - What's covered?
  - Who decides?

---

# THE SOURCE OF AUTHORITY

- The U.S. Constitution and federal laws enacted pursuant to the Constitution are the “supreme law of the land.” (Article VI, Cl. 2.)
- This is commonly known as the “Supremacy Clause.”
- But the Constitution does not include the words:
  - “Energy”
  - “Administrative” or
  - “Agency”
- So what is the source of federal government power to regulate energy?

---

# THE SOURCE OF AUTHORITY?

- Article I, Section 8 of the Constitution gives Congress (*i.e.*, the federal government) the power:
  - “To regulate commerce with foreign nations, and among the several States, and with the Indian Tribes.”
- This is commonly referred to as the “Commerce Clause,” and it is the main source of federal oversight and regulation of energy markets.
- Other sources include the right to regulate federal waterways (*e.g.*, hydropower regulation).
- Using this authority, Congress has passed federal laws regulating certain aspects of energy.

---

# WHAT'S COVERED?

- Congress has enacted numerous laws regulating energy, including:
    - The Federal Power Act (“FPA”)
    - The Natural Gas Act
    - Energy Policy Acts of 1992 and 2005
    - Public Utility Holding Company Act of 1935
    - Public Utility Regulatory Policies Act of 1978
    - Power Plant & Industrial Fuel Use Act
    - Hydropower Regulatory Efficiency Act of 2013
    - And many others....
- See <https://www.ferc.gov/legal/fed-sta.asp>  
(FERC website)

---

## WHAT'S COVERED?

- Using its Commerce Clause and related authority, Congress has extensively regulated energy, but...
- Commerce Clause authority is NOT unlimited. There is a key limiting principle. Recall, it must relate to “commerce ... among the several states.”
  - This is the “interstate” requirement of the Commerce Clause, which limits federal government power.
  - For example, the FPA regulates only “generation ... [and] transmission of electric energy in interstate commerce and the sale of such energy at wholesale.” (FPA §824(a).)

---

# WHAT'S COVERED?

- **Federal authority generally does NOT extend to in-state generation and transmission, or to in-state retail energy transactions.**
  - **Each state retains the right to regulate those non-interstate commerce activities and transactions.**
  - **The 10<sup>th</sup> Amendment to the Constitution: powers not delegated to the federal government under the Constitution “are reserved to the States respectively, or to the people.”**
  - **States regulate energy issues, including monopoly utilities, under the so-called state “police powers,” which allows each state to regulate behavior and enforce order within its territory for the betterment of the health, safety, morals, and general welfare of its inhabitants.**



---

## WHAT'S COVERED?

- **Hold on... how do we know what is and is not interstate commerce subject to federal regulation?**
  - **Can FERC issue a regulation that could impact in-state demand response market dynamics?**
- **How do we know what is a permissible exercise of state police power that is not pre-empted by the federal Supremacy Clause?**
  - **May a state pass a law to subsidize a desired form of generation, if the law affects the interstate wholesale electricity market?**

---

# WHO DECIDES?

- Ultimately, the courts decide.
  - *Marbury v. Madison* (1803): “It is emphatically the province and duty of the Judicial Department [the judicial branch] to say what the law is.”
- These types of questions are decided by federal and state courts.
- The Supreme Court of the United States has the final word.

---

## WHO DECIDES?

- Supreme Court energy cases are not common, but they do happen. The Court decided two energy cases in 2016:
  - *FERC v. EPSA*: Upholding FERC authority to regulate demand response transactions against a claim that the transactions are properly the subject of state-regulated retail markets.
  - *Hughes v. Talen Energy Marketing*: Rejecting a Maryland program that required load serving entities to enter into a specific contract with a state-chosen new generation source, because the program interfered with federally regulated wholesale rates.

---

## WHO DECIDES?

- A current case that may end up at the Supreme Court:
  - The Illinois and New York Zero Emission Credit (“ZEC”) programs that were set up to subsidize nuclear generation owned by Exelon.
- These cases are currently at the federal District Court (trial court) level.
  - Motions to dismiss are pending.

---

# WHO DECIDES?

- **Basic objection -- the ZEC programs subsidize Exelon nuclear plants and will skew federally regulated capacity markets, inhibiting new generation development and raising end-user power prices.**
- **Legal challenge – ZEC program is unconstitutional:**
  - **Will disrupt federally regulated wholesale electricity markets (“Pre-emption”).**
  - **Will impermissibly impact federally regulated interstate commerce (“Dormant Commerce Clause”).**
  - **Will impose costs on in-state customers that are not imposed on out-of-state customers (“Equal Protection Clause”).**

---

## WHO DECIDES?

- In the Illinois case, the Judge asked for FERC to weigh in, but FERC declined, because FERC does not yet have a position on the issue or a quorum to act.
- FERC held a two-day technical conference May 1-2, 2017 to examine the interplay and tensions between FERC's regulation of federal wholesale markets v. state-level actions on generation issues.
  - Issues were hotly contested. FERC has invited comments on potential pathways to resolution.
  - Initial Comments -- June 22; Reply Comments -- July 7.
  - Which brings us to our next topic....

---

# ADMINISTRATIVE PROCEDURES

- The Constitution does not mention “administrative law,” but in the energy world, administrative regulation is where **MUCH** of the action is.
- Federal and state laws direct the government to set up administrative agencies at both the federal and state levels:
  - FERC is the primary federal agency regulating energy, but other agencies are involved (*e.g.*, EPA, Dept. of Interior, Dept. of Energy).
  - Each state has a public utilities commission, and many states have other involved agencies.

---

# ADMINISTRATIVE PROCEDURES

- What do administrative agencies do?
  - Rulemaking.
  - Administrative adjudication.
  - Report to legislature.
  - Formulate and advise on policy/proposed legislation.
- Agencies take direction from legislative bodies, but agencies also can “lead the discussion” on cutting edge energy topics (*e.g.*, the NextGrid process in IL).



---

# ADMINISTRATIVE PROCEDURES

- Each agency typically has a governing statute that created the agency and governs the agency's operations.
  - For example, the Illinois Public Utilities Act created and governs the Illinois Commerce Commission, our public utilities commission.
- Administrative agencies also operate under laws of general application to administrative matters.
  - Federal Administrative Procedures Act of 1946 (the "APA") governs the activities of federal agencies.
  - Each state has its own "mini" APA.

---

# ADMINISTRATIVE PROCEDURES

- Agency activity is subject to court review:
  - Agency action in non-formal setting (*e.g.*, permit issuance) must not be “arbitrary and capricious,” an “abuse of discretion,” or contrary to law.
  - Agency action in a contested case must be based on “substantial evidence” based on the “whole record.”
- In practice, this means that courts frequently defer to agency decisions, particularly when the subject is technical and within the agency’s “expertise.”

---

# ADMINISTRATIVE PROCEDURES

- Why do courts “defer” to administrative agencies?
- Deference on factual matters:
  - The agency need not have the best or most accurate answer; it just needs to be reasonable, even if the court would not have reached the same factual conclusion itself.
  - Last week’s D.C. Circuit decision upholding FERC capacity market rules is a great example -- the court repeatedly deferred to FERC’s factual and policy conclusions. (*Advanced Energy Management Alliance v. FERC.*)

---

# ADMINISTRATIVE PROCEDURES

- **“Chevron deference.”** 1984 U.S. Supreme Court decision in *Chevron U.S.A. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). Most frequently cited case in administrative law.
  - Where a statute is clear, the agency must follow the unambiguous legislative direction.
  - However, “if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency’s answer is based on a permissible construction of the statute.”
  - Again, the agency need not have the best or even the “right” legal interpretation; it just needs to be reasonable, even if the court itself would have had a different interpretation of the law.

---

# COST ALLOCATION & RATE DESIGN

- Rate design is not about the “size of the pie.”
- Rate design is about “how the pie is split up.”
  - How much of the utility’s overall costs will be assigned to each customer class?
  - Law in each jurisdiction is different, but cost causation principles should be the key factor.
    - What facilities does each customer class use, and what facilities does each class not use?
    - A customer class that does not use a certain category of facilities should not have to pay for those facilities.

---

# **COST ALLOCATION & RATE DESIGN**

- **Rate design can have a serious impact on customer rates:**
- **With the 2017 ComEd Rate Design Case proposal that we will discuss in a moment, ComEd's rate increases due to rate design are now:**
  - **A 232% rate increase in average over 10 MW non-HV customers' rates over the 2005 level.**
  - **A 90% rate increase in average over 10 MW HV customers' rates over the 2005 level.**

---

# COST ALLOCATION & RATE DESIGN

- Illinois example:

- The Illinois Public Utilities Act states that “the cost of supplying public utility services” should be “allocated to those who cause the costs to be incurred.” (220 ILCS 5/1-102(d)(iii).)

- The Act similarly states:

Charges for delivery services shall be cost based, and shall allow the electric utility to recover the costs of providing delivery services through its charges to its delivery service customers that use the facilities and services associated with such costs.

(220 ILCS 5/16-108(c).)

---

## **CASE STUDY**

### **2017 ComEd RATE DESIGN CASE**

- **Historic practice: ComEd would update rate design in each periodic rate case.**
- **Under current law, ComEd must make a separate rate design filing every 3 years.**
  - **ComEd filed its most recent rate design update on December 18, 2016.**
  - **No changes formally proposed.**
  - **Filing was “suspended” by the ICC on January 25, 2017, initiating new case as ICC Docket No. 17-0049.**



---

# BACKGROUND

## ComEd 2013 RATE DESIGN CASE

- ICC Final Order -- issued December 18, 2013:
  - ICC Found that the largest customers are being allocated \$9 million in costs annually for facilities that they do not use. But, ICC then declined to correct that misallocation of costs.
  - Suggested that more accurate cost allocation would be potentially too complex.
  - Appellate Court deferred to ICC and affirmed decision, not because it found that the ICC was right – Court specifically withheld that judgment – but because in Court’s view the statute is ambiguous.

---

## **CASE STUDY**

### **ComEd 2017 RATE DESIGN CASE**

- **Potential cost impacts are significant:**
  - **Between 15% and 25% increase for most over 10 MW customers.**
    - **This is at least several hundreds of thousands of dollars each year for most over 10 MW customers.**
    - **Impact likely will last at least until 2022.**

---

# **CASE STUDY**

## **ComEd 2017 RATE DESIGN CASE**

- **Administrative law cases are moving increasingly quickly.**
- **Case Schedule:**
  - **March 15 - Staff/Intervenor Direct Testimony**
  - **April 5 - ComEd Rebuttal Testimony**
  - **April 26 - Staff/Intervenor Rebuttal Testimony**
  - **May 3 - ComEd Rebuttal Testimony**
  - **May 8/9 - Evidentiary Hearing**
  - **May 19 - Initial Briefs**
  - **May 26 - Reply Briefs**
  - **June 1 - Draft Proposed Orders**
  - **June 16 – ALJs’ Proposed Order**
  - **June 23 - Briefs on Exceptions**
  - **June 30 - Reply Briefs on Exceptions**
  - **August 15 - ICC Final Order**

---

# **CASE STUDY**

## **ComEd 2017 RATE DESIGN CASE**

- **June 16, 2017 ALJs' Proposed Order:**
  - Declines to reallocate \$9 million of costs currently charged to the ELL and HV Over 10 MW customer classes, for facilities that customers in those classes do not use.
  - Refuses to order ComEd to perform a statistically valid sampling study of *all* customer classes to determine the amount of usage of shared distribution lines by each class.
  - Endorses the so-called “next step” of rate increases for ELL and HV Over 10 MW customers.
  - Declines to address “weather normalization” in NextGrid.
  - Rejects request from some parties to switch from a Coincident Peak (“CP”) to a Non-coincident Peak (“NCP”) rate design approach.

---

# **CASE STUDY**

## **ComEd 2017 RATE DESIGN CASE**

- **Next steps include:**
  - **Reply Briefs on Exceptions (due June 30).**
  - **Possible Oral Argument.**
  - **Possible negotiated settlement.**

---

**Questions?**

**Discussion.**

**Thank you!**

**Chris Skey**

**312.517.7515**

**[cskey@clarkhill.com](mailto:cskey@clarkhill.com)**