

October 2024

Follow @Paul\_Hastings



# FERC Finalizes Rule Eliminating Cost Recovery for Reactive Rates

By [William D. DeGrandis](#) & [Gregory D. Jones](#)

On October 17, 2024, the Federal Energy Regulatory Commission (FERC) issued its final rule on reactive power compensation (Order No. 904)<sup>1</sup>, which finalized the plan outlined in its Notice of Proposed Rulemaking (NOPR) to eliminate cost recovery for generating facilities that provide reactive power within the standard power factor range. As expected, this ruling will impact project economics by reducing the revenues that generators and developers may recover for providing reactive power, which, in some cases, has represented an important revenue stream to ensure the continued viability of those facilities.

The anticipated sunset date for reactive rates is Q2 2025, but the exact timing will depend on a number of factors, as described in more detail below. Beginning on the effective date, such costs may only be recovered if a transmission provider directs a generator to operate *outside* of the standard power factor range as identified in its generator interconnection agreement.

## Summary of Order No. 904

In Order No. 904, FERC found there is substantial evidence that rate schedules allowing generators to recover their costs for providing reactive power within the standard power factor range are unjust and unreasonable.<sup>2</sup>

At a high level, the final rule reflects FERC's beliefs that generators incur little to no costs in providing reactive power within the standard power factor range. The Commission found that real and reactive power are joint products with joint costs that use the same generating facilities, which makes any attempt to allocate costs between real and reactive power "inherently arbitrary."<sup>3</sup> The Commission argues the only variable costs are limited to fuel costs or the cost of foregone direct current power, as real power not only uses the same equipment as reactive, but real power also provides reactive power functions.<sup>4</sup> Thus, FERC concludes that such costs are *de minimis* at best.<sup>5</sup>

FERC also found that providing compensation for reactive power may produce market distortions or otherwise result in undue compensation, and that good utility practice already obligates generators to

---

<sup>1</sup> *Compensation for Reactive Power Within the Standard Power Factor Range*, Order No. 904, 189 FERC ¶ 61,034 (2024) ("Order No. 904").

<sup>2</sup> *Id.* P 49.

<sup>3</sup> *Id.* P 90.

<sup>4</sup> *Id.*

<sup>5</sup> *Id.* P 91.

provide reactive power.<sup>6</sup> As a result, FERC found that the cost for providing reactive power within the standard power factor range is most appropriately done through payments for real power, and that any generators seeking to make up lost revenues to the loss of reactive power compensation can seek higher prices for sales energy and capacity.<sup>7</sup>

To implement its new policy direction on reactive power compensation in Order No. 904, FERC prescribed specific revisions to Schedule 2 of its *pro forma* Open Access Transmission Tariff (OATT), to Section 9.6.3 of the *pro forma* Large Generator Interconnection Agreement, and to Section 1.8.2 of the *pro forma* Small Generator Interconnection Agreement. FERC also directed that transmission providers submit compliance filings (as discussed below).<sup>8</sup>

FERC's action is not a surprise, especially after FERC announced its likely intention to eliminate reactive power compensation in the NOPR in this docket. In fact, the industry has observed a trend toward eliminating or restricting such compensation over the past several years. The Midcontinent Independent System Operator (MISO), for example, finalized its rules for sunseting reactive rate compensations. ISO-NE's and NYISO's reactive rate policy afforded generators a flat rate that did not yield significant compensation. The biggest impact of FERC's latest action appears to affect generators within PJM, where a number of generators have been receiving reactive power compensation for years. But in recent months, FERC has outright rejected certain reactive rate filings, not permitting them to take effect, for lack of supporting test and other data.<sup>9</sup> In previous years, FERC would set the section 205 filings for hearing, permit revenue recovery subject to refund, and allow the applicants to support their rate filings. Order No. 904 represents the culmination of FERC's change in direction on reactive rate compensation.

### Timing and Compliance Filings

In the aftermath of Order No. 904, the key questions now relate to compliance. FERC directs transmission providers to submit compliance filings proposing revisions to their open access transmission tariffs (OATTs) as specified in the final rule. These compliance filings are due within 60 days after the date of publication of the final rule in the *Federal Register* (which typically occurs some weeks after FERC's issuance of the order). These revisions must be effective within 90 days after the date of the compliance filing, essentially allowing a maximum of 150 days from the date of publication before reactive rates sunset. However, FERC has also clarified that ISOs and RTOs with capacity markets, including ISO-NE, NYISO and PJM, may request a longer implementation period than the 90 days afforded in Order No. 904.<sup>10</sup>

There are a fair number of implementation challenges that must be worked out in those compliance filings, particularly in regions like PJM, which has the most reactive rate schedules on file. In its NOPR comments, PJM explained that it may need to make several other revisions to its market rules, such as adjustments to its capacity market bidding rules, which would presumably go through the PJM stakeholder process. PJM noted that generators' capacity auction bids assumed the recovery of reactive revenues, and thus PJM may seek to allow recovery of those revenues until commencement of the next

---

<sup>6</sup> *Id.* P 9, P 27.

<sup>7</sup> *Id.* P 141.

<sup>8</sup> *Id.* PP 202-206.

<sup>9</sup> *New Market Solar ProjectCo 1, LLC*, 188 FERC ¶ 61,119 (2024).

<sup>10</sup> Order No. 904 at P 224.

Base Residual Auction in which removal of reactive power compensation can be reflected in the auction parameters.<sup>11</sup>

### Next Steps

Aggrieved parties that wish to challenge Order No. 904 may file a request for rehearing with FERC, which is due on November 18, 2024. In response to any requests for rehearing, FERC may affirm or overturn its prior findings in whole or in part, which would likely tee up any legal challenges for an appeal to a federal appellate court.

Order No. 904 also makes no mention of how it will dispense with pending settlements and ongoing settlement proceedings on reactive rates. A number of settlements, especially those which were contested, have been pending final FERC approval for years. FERC did not provide any direction in its final rule as to how the pending settlement cases, or cases where there are ongoing settlement discussions, will be handled in the wake of Order No. 904. We anticipate that the Commission, ISO staffs, and the individual settlement judges involved in the ongoing settlement proceedings will take action as to how these negotiations should be completed. As to the settlements already filed with the Commission and awaiting action, the Commission will need to direct next steps, as the settlement proceedings leading up to the filing of the settlements have been terminated once the settlements were filed with the Commission.

Close and careful monitoring of these compliance filings and other developments in connection with the upcoming reactive power compliance filings will be critical as the industry seeks to navigate these new rules.



*If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:*

#### Washington, D.C.

Bill DeGrandis  
1.202.551.1720  
[billdegrandis@paulhastings.com](mailto:billdegrandis@paulhastings.com)

Gregory D. Jones  
1.202.551.1941  
[gregoryjones@paulhastings.com](mailto:gregoryjones@paulhastings.com)

---

<sup>11</sup> PJM Interconnection, L.L.C., Comments on Reactive Power Capability Compensation, Docket No. RM22-2 at 5 (filed May 28, 2024).