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FERC Proposes Rule to Prohibit Reactive Power Compensation for Generators

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On March 21, 2024, the Federal Energy Regulatory Commission (FERC or Commission) issued a Notice of Proposed Rulemaking (NOPR) in Docket No. RM22-2 that proposes to prohibit transmission providers from allowing generating facilities to recover their costs associated with the supply of reactive power within the “standard power factor range” (i.e., 0.95 leading to 0.95 lagging). If adopted, the NOPR could have serious ramifications for generators that currently receive reactive power compensation or are developing projects in regions that currently allow generators to recover costs for the provision of reactive power.

Those regions include PJM, ISO-NE, and NYISO. Generating facilities located within the PJM region face the greatest impact, as PJM employs the *AEP* Methodology to derive cost-based rates for reactive power that oftentimes undergo a lengthy settlement and/or hearing process. Both the ISO-NE and NYISO regions employ flat rate designs that are adjusted for inflation, whereas CAISO, MISO, and SPP do not compensate generators for reactive power within the standard power factor range. MISO, in particular, recently received FERC approval to eliminate compensation in its footprint (and FERC repeatedly cited to that MISO order in its NOPR). Transmission providers outside of the ISO/RTO regions vary in whether they allow generators to receive compensation for reactive power, but those that do allow it typically employ the *AEP* Methodology.¹

Comments on the NOPR are due within 60 days of the date of publication in the Federal Register, with reply comments due 30 days thereafter. In particular note, the Commission seeks comments on the potential impact in reliability of prohibiting recovery of charges for reactive power supply with the standard power factor range, whether there should be a transition period to allow sufficient time to implement the new rule, and whether the final rule would disrupt business and investment decisions.

Summary of the NOPR

The Commission preliminarily found that providing reactive power compensation within the standard power factor range may produce unjust and unreasonable rates.² The Commission reasoned that generating facilities provide reactive power within the standard power factor range “at no cost or *de minimis* cost”, as there are generally few if any identifiable costs to provide reactive power, because variable costs are typically captured in the resource offers.³ Additionally, the Commission preliminarily determined that reactive power is administratively burdensome because: (1) it provides varied reliability benefits,⁴ (2) the process for determining reactive power rates is resource intensive and often results in black box settlements,⁵ (3) the process for testing and verification under the *AEP* Methodology often

requires multiple tests which yield inconsistent results across resources,⁶ and (4) the *AEP* Methodology's imprecision can lead to arbitrary increases in the utility's total recovery.⁷

As a result of the Commission's preliminary findings, the Commission proposes to prohibit transmission providers from including in their transmission rates any charges associated with the supply of reactive power within the standard power factor range from a generating facility.⁸ The Commission asserted that its proposal will ensure that transmission customers do not pay transmission rates that include costs without an economic justification and that such proposal will address any undue discrimination concerns regarding the disparate treatment of affiliated and non-affiliated generating facilities.⁹ The Commission seeks comment on the impact of its proposal on reliability and generating facilities' ability to recover their costs.

The Commission preliminary found that prohibiting transmission providers from including in their transmission rates any charges associated with the supply of reactive power within the standard power factor range from a generating facility will not negatively affect grid reliability.¹⁰ This is because obtaining and maintaining interconnection is conditioned on generating facilities providing reactive power within the standard power factor condition.¹¹ Through the NOPR, the Commission requested comment on the reliability impact of its proposal.¹²

The Commission also preliminarily found that compensation for providing reactive power is not necessary for the resources to recover their costs.¹³ Specifically, the Commission preliminarily found that in ISO/RTO markets, generating facilities' recovery of reactive power costs through energy and capacity sales will be more efficient and less administratively burdensome while increasing transparency.¹⁴ The Commission seeks comment on (1) the impact of reactive power payments on generating facilities' ability to recover their costs in the markets that currently provide reactive power compensation within the standard power factor range; and (2) the impact of the proposal on generators' investment and business decisions.¹⁵

To effectuate the changes discussed in the NOPR, the Commission proposes revisions to the *pro forma* OATT, *pro forma* Large Generator Interconnection Agreement,¹⁶ and the *pro forma* Small Generator Interconnection Agreement. These proposed changes would prohibit separate compensation for the provision of reactive power within the standard power factor range.¹⁷

Implications for Industry

If the Commission adopts the NOPR in its current form, then many generators and developers will have to work through a number of implementation issues. For example, in the PJM region, many generators have reactive power rate cases that are currently before the Commission, either in an active settlement or hearing, or with a negotiated settlement pending a final order from the Commission. The reactive rates in PJM tend to be higher than those in ISO-NE and NYISO, so the NOPR, and eventually the final rule, is likely to have a greater impact on those regional proceedings still ongoing. Other generators with reactive rates may be asked to provide cost support to continue receiving compensation for reactive power within the standard power factor range. Finally, any developers seeking to build or acquire a new generating facility should closely follow this proceeding to determine the extent to which reactive power compensation remains an additional revenue stream.

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

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¹ See *Compensation for Reactive Power Within the Standard Power Factor Range*, 186 FERC ¶ 61,203 (2024) (NOPR), at P 19.

² *Id.* at PP 24-27.

³ *Id.* at PP 28-29, 31.

⁴ *Id.* at P 35.

⁵ *Id.* at PP 36-37.

⁶ *Id.* at P 38.

⁷ *Id.* at P 39.

⁸ *Id.* at P 41.

⁹ *Id.* at P 42.

¹⁰ *Id.* at P 43.

¹¹ *Id.*

¹² *Id.* at P 44.

¹³ *Id.* at P 45.

¹⁴ *Id.* at P 46.

¹⁵ *Id.* at P 49.

¹⁶ *Id.* at PP 50-53.

¹⁷ *Id.* at P 50.

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