

FERC Reversal Tilts Playing Field For Transmission Projects

By **Keith Goldberg**

Law360, New York (May 16, 2014, 7:28 PM ET) -- The Federal Energy Regulatory Commission's conclusion that state laws that favor incumbent utilities don't have to be removed from tariffs to comply with its regional transmission planning rule will make it harder for independent developers to get their foot in the door, potentially undermining the directive's goal of greater competition for new projects, experts say.

In granting rehearings to grid operators Midcontinent Independent System Operator, PJM Interconnection and utility South Carolina Electric & Gas Co. on Thursday, the commission said that ignoring state laws such as ones that allow for right of first refusal to transmission projects for incumbent utilities at the start of the planning process outlined by FERC Order No. 1,000 could cause inefficiencies and delay new transmission projects.

Allowing those state laws to remain in FERC-jurisdictional tariffs and agreements reverses the commission's initial belief that state laws couldn't be used to exclude new entrants from participating in the regional transmission planning process at the outset, experts say.

"It sacrifices innovation for incumbency," said former FERC Chairman Jon Wellinghoff, who led the commission when it adopted Order No. 1,000 in 2011. "It is an about-face."

Those concerns were outlined in a dissent from FERC Commissioner John Norris.

"While there are many examples of innovative incumbent transmission developers, others may lack innovation and may be more interested in preserving the status quo to insulate themselves from competition," Norris said in a statement Thursday.

The removal of federal rights of first refusal, or ROFR, from FERC-jurisdictional tariffs was a key prong of Order No. 1,000, a measure meant to spark new transmission investment by requiring utilities to create regional plans and a framework for cost allocation, which is how they recoup project expenses. The rule also introduces competitive bidding into the construction of new transmission facilities and heaps new compliance requirements on public utilities.

The removal of federal ROFRs has been one of the most controversial provisions of Order No. 1,000. Utilities claim the provision strips their exclusive rights to build new power lines in their distribution areas while still keeping them on the hook for avoiding blackouts.

While Order No. 1,000 was never intended to eliminate state ROFRs, the concern is now that state and local requirements have been elevated to the point where they're automatically excluding potential projects from the planning process, said Akin Gump Strauss Hauer & Feld LLP energy regulatory partner Chip Cannon.

"If you have a project that might not necessarily get state approval, you can't participate in the process in the beginning," Cannon said. "I think it's another barrier to entry for the independent developers of transmission because it makes it that much more difficult to become eligible to actually participate in the process."

That could lead to fewer project proposals at the start of the process, which could undermine Order No. 1,000's goal of increasing competition for new transmission projects, said Wellinghoff, now an energy development partner at Stoel Rives LLP.

"A seminal part of Order 1,000 was ensuring that we can have competitive processes that allow for developers with innovative solutions to come forward and instigate efficiency into the system and save money for consumers," Wellinghoff said. "You have the same incumbents sitting around planning, you don't get anything new. All I think [Thursday's rulings] does is provide the incumbents with what they wanted: their ability to control the process."

While lack of competition is a valid concern, Hunton & Williams LLP partner Linda Walsh said FERC did require some significant changes to tariffs, such as requiring Midcontinent Independent System Operator to remove an arbitrary threshold that could have lumped in competitive projects with projects that could be considered merely upgrades and not subject to competitive bidding.

"If competitive projects are defined properly so that you do not have otherwise competitive projects unreasonably linked to projects in states with a ROFR, then that will ensure some level of competition," said Walsh, a former FERC attorney. "The goal would be to ensure that as many projects as possible fall into the competitive category, even given that some projects will be outside the process because of state ROFR laws and that some facilities will be considered upgrades."

And Cannon says the majority of FERC commissioners made a valid point in allowing the state laws to stay in the tariffs: why go through all the trouble of evaluating a proposal if it can't get built?

"I think that the states and the transmission providers in their filings made legitimate arguments as to the inefficient allocation of resources for projects that wouldn't be able to get the necessary approvals," Cannon said.

If anything, FERC's rulings Thursday are more of a clarification of their Order No. 1,000 aims than a wholesale policy change, according to Candice Castaneda of Paul Hastings LLP.

"I think it's consistent with FERC's statements throughout the Order No. 1,000 proceedings that nothing is changing or affecting state laws that exist," Castaneda said. "They don't want to accidentally create deficiencies and delays by ignoring things that are already there."

Getting state and federal approval for a major transmission project was a fact of life before Order No. 1,000 was enacted, said Schiff Hardin LLP partner Roger Smith, a former attorney for FERC and grid operator California Independent System Operator Corp. That didn't stop nonincumbent utilities from building new transmission projects, he said, citing projects such as northern California's Trans Bay Cable,

which went online in 2010 and supplies power to San Francisco.

"If anybody, incumbent or nonincumbent, wants to build transmission in the U.S., you will be regulated by FERC, unless you're in a nonjurisdictional area or government entity," Smith said. "You will have to apply for siting in the state public utility commissions that are along the route of your lines. Those are the realities."

Still, Cannon expects independent developers to push FERC to reconsider Thursday's rulings, raising many of the same arguments made by Norris in his dissent.

"If I were representing an independent transmission developer, I would take a close look at Commissioner Norris' arguments and weave them into a request for rehearing," Cannon said.

But if FERC holds firm, the only remaining option for developers may be to challenge state ROFR laws in court, Wellinghoff said.

"It's expensive for a developer to do that ... so it's going to be difficult for these challenges to succeed," Wellinghoff said.

--Additional reporting by Kurt Orzeck.