

MEMORANDUM

To: Transmission Committee

From: Eric Runge, NEPOOL Counsel

Date: August 20, 2014

Re: U.S. Court of Appeals Decision on Order Nos. 1000, 1000-A and 1000-B Appeals

On August 15, the U.S. Court of Appeals for District of Columbia Circuit (the “Court”) issued its decision (the “Appellate Decision”, in Docket No 12-1232) on multiple petitions for review of the Federal Energy Regulatory Commission (“FERC” or the “Commission”) Order Nos. 1000, 1000-A and 1000-B (collectively, Order 1000).¹ The Court upheld Order 1000 against all of the challenges raised in the petitions for review. This memo provides a brief summary of the Court’s primary holdings on appeal, but does not examine all of the arguments raised on appeal and the Court’s treatment of them. Note that this Appellate Decision is not decisive regarding pending requests for rehearing in particular regional Order 1000 compliance proceedings, including New England’s, but only applies to the appeals filed regarding FERC’s determinations in the generic Order 1000 proceedings. If you have any questions about this memo, please contact: Eric Runge, 617-345-4735, ekrunge@daypitney.com.

The Court decided six main areas of dispute on appeal: (1) whether the FERC has authority to require transmission providers to participate in a regional transmission planning process; (2) whether the Commission’s reliance on a theoretical threat to the cost effective and efficient development of new transmission facilities as justification of its Order 1000 transmission planning and cost allocation reforms satisfies the substantial evidence standard of FERC decision-making; (3) whether the FERC has authority to require removal of federal rights of first refusal provisions upon finding they were unjust and unreasonable practices affecting rates; (4) whether the FERC has authority to require *ex ante* cost allocation² of regional transmission facilities; (5) whether the Commission reasonably determined that regional transmission planning must consider public policy requirements that drive transmission needs; and (6) whether the Commission reasonably relied on the reciprocity requirement of the open access transmission tariff to encourage non-public utility transmission providers to participate in regional planning processes. Each of these main areas of decision are summarized below.

First, the Court upheld the Order 1000 regional planning mandate on the grounds that: (1) the FERC has the authority Under Section 206 of the Federal Power Act to make the requirement if existing planning practices are unjust or unreasonable, because regional planning is an existing

¹ Several petitions for review were consolidated and addressed together in this one Appellate Decision. The Appellate Decision has been included with this memo.

² *Ex ante* cost allocation in this context refers to a method or methods established in open access transmission tariffs for the allocation of transmission costs known in advance of incurring such costs.

“practice” affecting rates³; and (2) other provisions of the Federal Power Act do not preclude the FERC’s mandate of regional planning, including Section 202(a) of the FPA, which provides for voluntary coordination of generation and transmission facilities, and Section 201(a) of the FPA, which limits FERC’s jurisdiction over transmission to those matters that are not subject to regulation by the states.

Second, the Court held that the theoretical threat to cost effective and efficient transmission development was substantial evidence legally sufficient to support a Commission finding that existing transmission planning and cost allocation practices are unjust, unreasonable, unduly discriminatory or preferential.⁴ Such a finding does not have to be supported by empirical evidence but can instead be based on sound economic theory, such as the theory that more competition in transmission development will lead to more effective and cost-effective solutions to identified transmission needs.⁵ The Commission may rely on generic findings, including reasonable predictions, to address a systemic problem that has been identified, which in this case is the industry’s need for more efficient and cost-effective transmission.⁶ Based on its expertise and experience, the Commission’s determination that the current planning and cost allocation practices were unjust or unreasonable warrants substantial deference from the court on appeal.⁷

Third, the Court upheld the Commission’s mandate that public utility transmission providers remove federal rights of first refusal from jurisdictional contracts and tariffs.⁸ While Section 206 of the FPA does not have express language authorizing the Commission to mandate the removal, the statute does give the Commission authority to require changes to practices affecting rates. The rights of first refusal are sufficiently connected to rates that they are a practice affecting rates within the meaning of Section 206 of the FPA.⁹ Transmission providers recoup the costs of their facilities through rates, and competition in transmission development, or lack thereof, will affect the cost of those facilities.¹⁰ Additionally, the Court concluded that where Section 206 of the FPA is ambiguous regarding specific authority of the Commission, the Commission’s interpretation of its authority will be upheld if reasonable.¹¹ The Court concluded

³ See Appellate Decision at pp. 18-25.

⁴ See Appellate Decision at 35-48.

⁵ *Id.* at 36-43.

⁶ *Id.* at 36, 41.

⁷ *Id.* at 41.

⁸ *Id.* at 49-67.

⁹ *Id.* at 53-58.

¹⁰ *Id.* at 54.

¹¹ *Id.* at 58.

that the Commission's interpretation of Section of the FPA in this instance was reasonable.¹² Additionally, the Commission adequately supported with substantial evidence in the form of economic competition theory its finding that the practice of rights of first refusal was unjust, unreasonable, unduly discriminatory of preferential.¹³ The Court rejected *Mobile-Sierra*¹⁴ challenges to the Order 1000 rights of first refusal requirement on the grounds that such challenges were not ripe for review given that the Commission said in Order 1000 it would address *Mobile-Sierra* arguments on a case-by-case basis on compliance.¹⁵ Thus, the *Mobile-Sierra* arguments that have been raised in New England and elsewhere on rehearing have not been disposed of by the Appellate decision, though one can discern where the Court might be more likely to come out on appeal.

Fourth, the Court upheld Order 1000's requirements regarding cost allocation.¹⁶ The Commission acted within its authority to require *ex ante* cost allocation methods.¹⁷ The allocation of transmission costs is a practice affecting rates and is therefore within the authority of the FERC to modify under Section 206 of the FPA.¹⁸ No limitation exists in Section 206 that unambiguously forecloses the Commission from mandating the allocation of costs beyond pre-existing contractual or customer relationships.¹⁹ The Commission's interpretation of its authority under Section 206 to require cost allocation methods is reasonable, and therefore, the Court must defer to the administrative agency responsible for administering the statute.²⁰ The adoption of a beneficiary-based cost allocation method is a reasonable extension of the cost causation principle.²¹ Additionally, the Commission's cost allocation principles, and particularly the principle that precludes allocation of costs involuntarily to those outside one's region are not

¹² *Id.* at 57.

¹³ *Id.* at 58-60.

¹⁴ Under the *Mobile-Sierra* doctrine developed through court precedent, there is a presumption that freely-negotiated wholesale-energy contracts are just and reasonable unless found to seriously harm the public interest. For any non-voluntary change to contract provisions containing *Mobile-Sierra* protection, the Commission must find that allowing the contract provisions to stay in place would harm the public interest.

¹⁵ *Id.* at 66-68.

¹⁶ *Id.* at 68-82.

¹⁷ *Id.* at 72-74.

¹⁸ *Id.*

¹⁹ *Id.* at 73-74.

²⁰ *Id.* at 74-78.

²¹ *Id.*

arbitrary or capricious but are based on sound economic principles, including the cost causation principle.²²

Fifth, the Court upheld the Commission's mandate that public policy requirements be considered as part of the regional transmission planning process.²³ The Commission is not promoting any particular public policy goals outside the FPA and is therefore not acting beyond its authority by requiring such consideration of public policy requirements.²⁴ The public policy mandate bears directly on the provision of transmission service and is therefore directly within the scope of the Commission's authority.²⁵ The public policy mandate applies to utilities, not the Commission, and does not violate the FPA's requirement that the Commission exercise its authority in a manner that facilitates the planning and expansion of transmission facilities to meet the reasonable needs of load serving entities to satisfy their service obligations.²⁶ The fact that Order 1000 allows regions to exercise flexibility in how to comply with the public policy mandate does not render the mandate impermissibly vague.²⁷ Order 1000 requires public policy related processes and not outcomes. Details of the processes are appropriately left to some discretion on the part of the complying utilities.²⁸

Finally, the Court upheld the Commission's use of the reciprocity requirement of the open access transmission tariff to encourage non-public utility transmission providers to participate in regional planning processes.²⁹ Under the reciprocity requirement if a non-public utility transmission provider takes transmission service from a public utility, it becomes subject to the same terms and conditions of open access transmission service. Order 1000's reciprocity requirement is not a departure from Order No. 888's reciprocity requirement but merely an expansion of it to include regional transmission planning and cost allocation.³⁰ Section 211A of the FPA did not require that the Commission extend Order 1000's planning and cost allocation requirements to apply directly (rather than through reciprocity) to non-public utility transmission providers.³¹

²² *Id.* at 78-82.

²³ *Id.* at 82-88.

²⁴ *Id.* at 83-84

²⁵ *Id.* at 84.

²⁶ *Id.* at 84-85.

²⁷ *Id.* at 86-87.

²⁸ *Id.* at 87.

²⁹ *Id.* at 88-97.

³⁰ *Id.* at 91-94.

³¹ *Id.* at 94-97.