

August 21, 2014

## D.C. Circuit Rejects Challenges to FERC's Order No. 1000

*The court turned back all challenges to FERC's order, which imposed major regional transmission planning requirements, concluding that FERC has adequately justified the order and acted within its statutory authority.*

On August 15, the U.S. Court of Appeals for the District of Columbia Circuit rejected the challenges filed by various utilities, industry groups, and state commissions that claimed that the Federal Energy Regulatory Commission (FERC or the Commission) overstepped its authority when promulgating Order No. 1000.<sup>1</sup> The court's decision in *South Carolina Public Service Authority v. FERC*,<sup>2</sup> which FERC Chairman Cheryl LaFleur hailed as "critical to the Commission's efforts to support efficient, competitive, and cost-effective transmission,"<sup>3</sup> substantially strengthens FERC's ability to establish the structures necessary to encourage and facilitate competitive transmission planning and development.

### FERC Had the Authority to Promulgate the Rule

Certain petitioners had challenged FERC's authority to regulate transmission planning under section 206 of the Federal Power Act. These petitioners claimed that FERC's authority is limited to regulating voluntary planning arrangements and does not extend to requiring the new regional planning arrangements mandated by Order No. 1000.

The court rejected this argument, finding that the transmission planning practices regulated by Order No. 1000 are practices that affect rates. The court noted that what constitutes a "practice" is broad and that failing to engage in regional planning is itself a practice. The court viewed Order No. 1000 as "simply the next step" in the transmission planning reforms that began in Order No. 890, and which themselves grew out of Order No. 888.

The court also rejected claims that section 202(a) of the Federal Power Act prevents FERC from mandating transmission planning. Section 202(a) authorizes the Commission to divide the United States into districts and to promote the "voluntary interconnection and coordination of facilities" in those districts. According to the court, the Commission's interpretation that applied section 202(a) only to coordinated operations, as distinguished from pre-operational planning, was permissible.

Finally, the court rejected claims that Order No. 1000 impermissibly intrudes on states' authority to regulate the siting and construction of transmission, particularly because section 201(a) limits the Commission's authority to "only those matters which are not subject to regulation by the States." The court found that FERC "possesses greater authority over electricity transmission than it does over sales," and that, although FERC's authority over sales is limited to wholesale sales, there is no textual limit in the statute that indicates that FERC lacks jurisdiction over retail transmission. With this background, the court concluded that Order No. 1000 did not intrude on states' authority because Order No. 1000 relates only to electric transmission and therefore falls within FERC's broad authority in that area, particularly because Order No. 1000 is aimed at the interconnected grid that spans state lines. The court used this to distinguish its decision from its recent decision in *Electric Power Supply Ass'n v.*

1. View the order at <http://www.ferc.gov/whats-new/comm-meet/2011/072111/E-6.pdf>.

2. No. 12-1232 (D.C. Cir. Aug. 15, 2014), available at <http://www.ferc.gov/media/statements-speeches/lafleur/2014/08-15-14-lafleur.pdf>.

3. Statement of Chairman Cheryl A. LaFleur, FERC (Aug. 15, 2014), available at <http://www.ferc.gov/media/statements-speeches/lafleur/2014/08-15-14-lafleur.asp>.

FERC,<sup>4</sup> which had rejected an attempt by FERC to regulate retail electricity sales.

## **FERC Provided Substantial Evidence to Support Its Conclusions**

Petitioners had also challenged FERC's conclusion that structural shortcomings in current planning efforts and cost allocation practices justified the remedies imposed in Order No. 1000. According to those petitioners, FERC's claim of a theoretical threat is an insufficient evidentiary basis for the rule.

The court rejected this argument, explaining that FERC need not provide empirical evidence of the problem it seeks to solve. The court noted that the problem was well supported by comments and other evidence in the record, including industry studies that demonstrate the need for transmission investment. The court also rejected challenges to the Commission's degree of certainty regarding its proposed improvements to regional planning, noting that, when predicting the future effect of a rule, FERC can rely on generally accepted principles, such as the benefits of competition.

## **FERC Has the Authority to Require the Removal of Rights of First Refusal**

One of the reforms introduced by Order No. 1000 was the requirement that any rights of first refusal be removed from all FERC-jurisdictional tariffs and agreements. These rights grant the incumbent utility the right to construct any new transmission facilities in its footprint, even if a project is proposed by a competitor.

The court held that it was within the Commission's authority over practices that affect rates to require the removal of rights of first refusal because "a generally accepted principle of economics directly connects rights of first refusal to rates." The court noted that potential competitors are not likely to propose projects because they would not likely be able to build the projects they propose. This reduces competition and, therefore, likely increases rates.

The court also rejected claims that removing rights of first refusal would undermine the benefits of vertical integration, including by replacing project development by experienced and knowledgeable utilities with projects by new and untested developers. Although there are reliability risks presented by bringing in nonincumbent developers, the court concluded that FERC reasonably addressed those concerns through mechanisms such as the use of minimum developer qualifications, processes for monitoring project development, the right of incumbents to develop upgrades and local facilities, and the obligation to comply with reliability standards.

The court went on to reject the other reliability concerns that the petitioners presented, including concerns under section 215 of the Federal Power Act. According to the court, Order No. 1000 did not violate section 215's requirements for reliability standard development when the Commission imposed a new North American Electric Reliability Corporation (NERC) mitigation plan process because in doing so no reliability standards were modified. The court also found that Order No. 1000 did not violate the prohibition on FERC ordering the construction of new transmission capacity because utilities mitigating violations could use methods other than construction of new facilities. Finally, the court concluded that utilities would be completely protected from reliability sanctions caused by nonincumbent developer failures because, even if NERC imposed such a sanction, FERC has committed not to penalize utilities in those circumstances and could free incumbent transmission providers from any such penalties.

The court refused to address claims that FERC violated the *Mobile-Sierra* doctrine by directing modifications to FERC tariffs and agreements to remove the right of first refusal. The court explained that the Commission had promised to address individual contracts on compliance and noted that it would review those decisions as they arose.

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4. 753 F.3d 216 (D.C. Cir. 2014).

## **FERC May Require the *Ex Ante* Allocation of Facility Costs Among Beneficiaries**

In Order No. 1000, the Commission concluded that it is necessary to require a method for *ex ante* allocation of the costs of new transmission facilities to ensure that those who benefit from the facilities pay for them. Certain petitioners challenged that decision, claiming that FERC lacked the authority to require such allocation. Others claimed FERC did not go far enough.

The court rejected those challenges, explaining that mandating the allocation of costs using a beneficiary-pays protocol is within the scope of FERC's authority over practices that affect rates. The court also concluded that a beneficiary-based cost allocation methodology would appropriately address the potential for free riders. Finally, the court concluded that limiting mandatory cost allocation to within regions was an appropriate balance between using a beneficiary-pays methodology and imposing a workable scope to identify beneficiaries.

## **FERC Reasonably Concluded That Regional Planning Should Consider Public Policy Requirements**

The court rejected each challenge to the Commission's requirement that regional planning account for federal, state, and local laws and regulations, such as renewable portfolio requirements. The court explained that FERC was not attempting to generically promote the public welfare, as some petitioners contended, but rather was recognizing that transmission planning needs to account for a variety of factors, including laws and governmental policies. The court also concluded that planning for these public policy requirements is consistent with FERC's obligations to load-serving entities. Finally, the court rejected claims that the public policy requirements were too vague to be workable, explaining that the requirement is for regions to develop processes and that affording the regions broad discretion to develop their own processes does not make the obligation unworkably vague.

## **FERC Reasonably Relied on Reciprocity to Encourage Nonpublic Utility Participation**

The court concluded by rejecting claims that the Commission should not have used its reciprocity policy to encourage nonpublic utilities to participate in Order No. 1000 regional planning. Under reciprocity, a nonpublic utility's ability to take transmission service from public utilities is tied to the nonpublic utility's willingness to accommodate FERC's transmission policies, including the regional planning requirements in Order No. 1000.

The court explained that FERC used reciprocity in Order No. 1000 in the same way it used reciprocity in prior orders and that it explained why it was changing the scope of the reciprocity condition to accommodate regional planning. Nonpublic utilities need not take any action unless they choose to do so.

Finally, the court rejected claims that FERC should have used its authority under section 211A of the Federal Power Act to mandate participation in Order No. 1000 regional planning by nonpublic utilities. The court held that the use of section 211A is discretionary and that FERC adequately explained why it chose to rely on voluntary participation. The court did not find the evidence in the record sufficient to contravene FERC's judgment that nonpublic utilities are likely to participate. The court noted that the petitioners raised concerns about possible free-riding by nonpublic utilities, but it deferred to FERC's decision to leave the use of section 211A in that context for another day.

## **Other Legal Issues Related to Order No. 1000 Remain Unresolved**

Although the D.C. Circuit's decision upheld Order No. 1000 against all of the broad challenges brought against it, several key issues created by Order No. 1000 may result in future legal challenges on narrower topics that are more fact-specific. These include the following:

- Whether the *Mobile-Sierra* language in certain regional transmission organization tariffs will protect the existing rights of first refusal in those tariffs
- How NERC will implement the mitigation plan structure for reliability standard violations that result from nonincumbent project failures
- How disputes over project and project developer selections will be resolved by FERC

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- Whether there will be disputes over the cost allocations that result from regional planning processes, and, if so, how FERC will resolve them
- How FERC will provide for the billing of costs from transmission project developers to entities with which the developer has no contractual or tariff relationship

## Contacts

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