May 23, 2013

FERC Rules That Competitive Transmission Trumps Negotiated Contract Rights

In a May 17 order (the "New England Compliance Order") on the New England compliance filing in response to Order No. 1000[1] ("Order 1000"), the Federal Energy Regulatory Commission ("FERC") rejected efforts by the New England transmission owners to retain their exclusive rights to build new?transmission in the region. In doing so, FERC declared its "plenary authority" to abrogate or substantially modify contracts?- even those protected by the *Mobile-Sierra* doctrine[2]?- if changes in FERC's jurisdictional industries warrant such actions. FERC's bold sweeping away of federal rights of first refusal ("ROFRs") or exclusive rights to build and own regional transmission, including one expressly protected by a *Mobile-Sierra* provision, will likely result in federal appeals that will further shape *Mobile-Sierra* law. In the meantime, FERC has reshaped the electric transmission industry to open it up to competitive transmission development.

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Order 1000, which resulted from a FERC rulemaking proceeding, is designed to reform FERC's electric transmission planning and cost-allocation requirements for public utility transmission providers. The ROFR elimination is the most controversial aspect of Order 1000 compliance and brings into play *Mobile-Sierra* legal precedent. Under *Mobile-Sierra* precedent, for FERC to order any nonvoluntary change to contracts protected under *Mobile-Sierra*, FERC must first find that allowing the subject contract provisions to stay in place would harm the public interest, a more stringent standard than the ordinary "just and reasonable" standard. Thus, to abrogate or involuntarily modify contracts that have *Mobile-Sierra* protection, FERC must first conduct a public interest analysis. FERC announced its intention to eliminate ROFRs first in Order 1000, reaffirmed that intent on rehearing in Order No. 1000-A, and first implemented that intent in its orders on the compliance filings of PJM and MISO in March ("the PJM and MISO Compliance Orders"). In the PJM and MISO Compliance Orders, FERC was able to eliminate the ROFRs without going through a public interest analysis because the contracts did not have express *Mobile-Sierra* protection by their own terms and FERC found no presumption of *Mobile-Sierra* protection was justified. FERC reasoned that the *Mobile-Sierra* presumption applies to a contract only if the contract has certain characteristics that justify the presumption. FERC found the MISO and PJM contract provisions in question apply beyond the parties that negotiated the contract to limit the rights of third parties and arose in circumstances that do not provide the assurance of justness and reasonableness associated with arm's-length negotiations, because the negotiations were aimed at protecting a common interest among transmission owners. Based on this analysis, FERC concluded the *Mobile-Sierra* presumption did not apply to protect the ROFR provisions in MISO and PJM.

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In the New England Compliance Order, FERC was faced with an express *Mobile-Sierra* provision protecting the ROFR. FERC had approved that provision in its 2004 RTO order for New England. Nevertheless, FERC overcame that obstacle to its policy, based on the following analysis. FERC first determined no automatic *Mobile-Sierra* protection applied to the New England ROFR, because it is a contract rate of general applicability that restricted the rights and abilities of others to compete and because it was negotiated among transmission owners with common interests. Second, although in the 2004 RTO order FERC determined that *Mobile-Sierra* protection would apply to the New England ROFR, FERC found here that the public interest would be harmed by retaining the ROFR, because the transmission industry has changed since then. In support FERC found there is a greater need for new transmission, and there are independent transmission developers awaiting the opportunity to compete to build this needed transmission. FERC found that retaining the ROFR would prevent such competition and hinder needed transmission development. FERC stated that removal of barriers to participation by nonincumbent transmission developers in the regional transmission planning processes lies at the core of Order 1000 and is essential to meeting the demands of changing circumstances facing the electric industry. Third, FERC concluded it may use

its generic findings regarding the harmful effects of ROFRs in the Order 1000 rulemaking to support its public interest determination and noted it has previously abrogated and modified contracts based on generic rulemaking findings, with such determinations being upheld on appeal, most notably under its landmark Orders No. 888 and 636. Framing the battle for the almost certain appeal, FERC asserted the *Mobile-Sierra* doctrine does not bar FERC from exercising its "plenary authority" to modify or abrogate contracts that adversely affect the public interest, especially in the context of implementing new regulations.

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Thus, with the New England Compliance Order FERC has eliminated the final and best-protected ROFR, at least for now. Requests for rehearing of the New England Compliance Order are due by mid-June.[3] After FERC rules on the rehearing requests, parties can appeal the ruling to the U.S. Court of Appeals. Perhaps years from now we will find out from a federal appeals court how well FERC's view of its authority squares with the legal requirements for abrogating or modifying *Mobile-Sierra*-protected contract rights. In the meantime, transmission providers across the country must prepare for the bold new world of competitive regional transmission development.?

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[1] *Transmission Planning and Cost Allocation by Transmission Owning and Operating Public Utilities*, Order No. 1000, FERC Stats. & Regs. ? 31,323 (2011), order on reh'g, Order No. 1000-A, 139 FERC ? 61,132, order on reh'g, Order No. 1000-B, 141 FERC ? 61,044 (2012).

[2] The *Mobile-Sierra* doctrine originated in the Supreme Court's decisions in *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956) (*Mobile*), and *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956) (*Sierra*).

[3] Requests for rehearing of the PJM and MISO Compliance Orders on the issue of the ROFR elimination were filed on April 22.