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Billions of Dollars at Stake in New Federal Energy Regulatory Commission Inquiries Into Its ROE and Electric Transmission Incentive Policies

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The Federal Energy Regulatory Commission ("FERC") recently issued two Notices of Inquiry ("NOIs") regarding interrelated policy areas: (1) determining a just and reasonable Return on Equity ("ROE") and (2) electric transmission incentive rates. Both NOIs seek comments from all interested stakeholders in the electric industry, but the NOI on FERC's ROE policy also invites comments from interested stakeholders in the natural gas pipelines and oil pipelines industries, as such industries are potentially affected by this inquiry. Initial comments on the NOI on ROE policy are due June 26, 2019, and reply comments are due July 26, 2019.[1] Initial comments on the NOI on transmission incentives policy are due June 25, 2019, and reply comments are due July 25, 2019.[2]

As discussed more fully below, ROE and incentive rates have substantial financial and policy implications for a wide range of industry participants, and these NOIs will draw comments from many different types of industry participants. While the NOIs themselves will not lead to new FERC regulations, they could be the basis for formal Notice of Proposed Rulemakings ("NOPRs") in which FERC will announce new rules and regulations in the field plowed by the NOIs.

I. *Notice of Inquiry on ROE Policy (Docket No. PL19-4-000)*

In the first NOI, *Inquiry Regarding the Commission's Electric Transmission Incentives Policy*, 166 FERC ¶ 61,208 (2019), FERC seeks comments on eight general topics for the purpose of determining whether FERC should revise its framework to determining a just and reasonable ROE for public utilities, including whether such revisions, if any, should be applied to natural gas pipelines and oil pipelines. In FERC's October 16, 2018 Order on Remand from the United States Court of Appeals for the District of Columbia Circuit's decision in *Emera Maine v. FERC*,[3] FERC proposed a new framework for determining a public utility's base ROE thereby moving away from its traditional approach of relying solely on the Discounted Cash Flow ("DCF") model. This new framework gives equal weight to four financial models (DCF model, capital asset pricing model, risk premium model, and the expected earnings analysis) by averaging the results of all four models in determining a just and reasonable ROE. FERC also established a paper hearing to consider whether and how this new framework should apply to the proceedings pending before it involving the ROE for the transmission owners of the Midcontinent Independent System Operator, Inc. ("MISO").[4]

The NOI on ROE recognizes that interest in the ROE policy expands beyond the parties in *Emera Maine* and in the MISO Briefing Order and thus seeks to provide all interested stakeholders with an opportunity to comment on FERC's new approach. Such interested stakeholders will include private equity and other investors in electric transmission and gas/oil pipelines; lenders; developers; customers; and state commissions. Investors, developers, owners, and lenders will want to ensure there are incentives for their investments in these sectors, and customers will push back to the extent they believe that changes to the Commissions' ROE and incentive rate policies could lead to unjust and unreasonable rates.

It is worth noting that FERC has not yet acted on these ROE proceedings in which FERC directed further briefing consistent with the new framework, and the NOI on ROE does not address how this inquiry would affect these pending proceedings, but given the ample time allowed for comments, FERC may well try to decide these proceedings on their merits before the conclusion of this general inquiry.

The NOI on ROE enumerates the following eight topics on which FERC is seeking stakeholder comments:

- The role of FERC's base ROE in investment decision-making and what objectives should guide FERC's approach;
- Whether FERC's base ROE policy should uniformly apply across the electric, interstate natural gas pipeline, and oil pipeline industries;
- The performance of the DCF model;
- The composition of proxy groups;
- The financial model, or combination of financial models, that FERC should utilize;
- The mismatch between market-based ROE determinations and book-value rate base;
- How FERC determines whether an existing ROE is unjust and unreasonable under the first prong of the analysis under section 206 of the Federal Power Act ("FPA"); and
- The mechanics and implementation of the financial models.[5]

II. *Notice of Inquiry on Transmission Incentives Policy (Docket No. PL19-3-000)*

In the second NOI, *Inquiry Regarding the Commission's Electric Transmission Incentives Policy*, 166 FERC ¶ 61,208 (2019), FERC seeks stakeholder comments on the transmission incentive rates policy it developed in Order No. 679 in response to Congress' directives in section 219 of the FPA to establish transmission incentives for the purpose of "benefitting customers by ensuring reliability and reducing the cost of delivered power by reducing transmission congestion."[6] FERC explained that in light of developments in the transmission sector and the experience gained over the 13 years since the issuance of Order No. 679, FERC believes it is prudent to seek comment on whether and how to improve FERC's current transmission incentives policy.

The NOI on Incentives is wide ranging and examines many topics, including (1) whether incentives should continue to be based on a project's risks or challenges, or whether they should be based more broadly on the reliability and economic benefits they can provide; (2) whether transmission incentives could better encourage enhancements to existing facilities and asks how evolving transmission technologies could be more thoughtfully considered in the context of FERC's transmission incentives policy; (3) Whether FERC should use its incentives policy to foster cybersecurity and physical security of jurisdictional transmission facilities; (4) how should evolving transmission technologies fit into the incentives policy; and (5) whether consideration to the costs and benefits of projects should be provided in awarding incentives.

The NOI on Incentives also addresses ROE-adder incentives that FERC has established by seeking comments on the requirements for, the level of, and the design of these incentives, as well as their relationship to the calculation of base ROEs.

The NOI also looks at FERC's approach in granting incentives, including (1) whether some incentives should be granted on a generic basis rather than the current case-by-case approach; (2) whether there should be more analysis of the combinations of incentives and levels of any ROE adders; and (3) whether additional structure and guidance regarding FERC's approach should be added to the evaluation process.

III. *Implications*

The NOIs discussed herein have the potential to substantially impact FERC's policies on ROE and transmission incentives. The Commission in recent orders and some Commissioners in published statements of speeches have alluded to the need to take a relook, and potentially a reboot, of FERC's transmission incentive rate policies.

Although the extent to which FERC will revise these policies at issue is unknown at this point, one can reasonably infer that the holistic approach to these inquiries could lead FERC potentially to use these proceedings to overhaul its current policies on ROE and transmission incentives. Indeed, FERC Commissioners recognized the wide scope and impact of these proceedings in the March 21, 2019 FERC public meeting that discussed these two NOIs. Chairman Neil Chatterjee, for example, stated that these policies will have a "huge impact on shaping the grid of tomorrow" and will be "an important step towards getting transmission policies right." Commissioner Cheryl LaFleur noted, "I believe it's a good time to take a fresh look at our incentives policies" to see if reforms are needed to better align FERC's policies with the goals set forth in section 219 of the FPA. Commissioner Richard Glick also chimed in, indicating that FERC wants "to provide the right investment environment for companies seeking to build transmission or improve the efficiency of their existing facilities. . . ." These proceedings thus will provide interested stakeholders an opportunity for a holistic review and potential modifications of FERC's policies in these areas.

In response to these policy inquiries, transmission customers may take this opportunity to argue, *inter alia*, in favor of the DCF as the sole model for determining a just and reasonable ROE, as the new *Emera Maine* ROE policy is viewed as being too generous to transmission owners. Customer groups may also argue that currently, several of the transmission incentives are not rendering the benefits FERC discussed in Order No. 679 and as a result, there is a definite need for these incentives to be revisited to determine whether elimination or reduction in level would be appropriate. There may also be some push back from stakeholders in the natural gas pipelines and oil pipelines industry as it relates to expanding the ROE framework for public utilities to all the FERC-regulated industries.

On the other hand, transmission owners, developers and investors alike will take this opportunity to support FERC's current framework for determining a just and reasonable ROE and may propose modifications, either to the mechanics of the financial models or to the final placement of the base ROE, to properly reflect the risks the developers and investors face in the current market conditions.

They may well point out that while the customer groups can content that the current ROE levels are higher comparatively to other industries' ROEs, there are substantial development risks involved, and the ROEs are applied not to the value paid for transmission facilities, but in most cases the ROE only applies to the net book value of the purchased transmission assets, which is often much lower than the purchase price paid for transmission assets. In addition, developing new transmission projects entail development risks, where regulatory and permitting approvals may delay projects, and many new projects entail substantial capital investment. The transmission owners/developers may also point out that even responding to Requests for Proposals ("RFPs") for new Order No. 1000 or other transmission projects can cost hundreds of thousands, if not millions, in preparing responses to such RFPs. The project sponsors understandably need detailed proposals in order to select the developer with the right plan and experience to develop the proposed transmission project, and the responses are costly and extensive. Transmission owners and developers may also support the existing transmission incentives by pointing to the improvements in transmission development following the issuance of Order No. 679, and they will likely argue in favor of additional transmission incentives based on expected project benefits and/or project characteristics.

IV. *Conclusion*

In sum, the dollar value implications of the NOIs on ROEs for electric transmission and gas/pipeline companies and on electric transmission rate incentives can impact billions of dollars of present investment in these key infrastructure sectors of our nation's economy, and depending on where the Commission comes out on these issues, could either encourage more, or dampen interest in, further investment in these sectors. Many affected stakeholders will want to participate in these NOI proceedings, by providing comments individually or participating in industry groups that collectively comment on these important issues. In the least, stakeholders will want to closely monitor the filed comments and Commission pronouncements along the way, as the NOIs may well lead to a NOPRs that will formally announce new rules and regulations in the field plowed by the NOIs.

As noted above, comments on the NOE on ROE and the NOI on Incentives are due June 26, 2019, and June 25, 2019, respectively.

It is understood that this Alert in no way constitutes legal advice. Feel free to contact the following Paul Hastings Energy Team members if you have any questions about these NOIs and the important legal/policy issues that they raise.

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

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[1] *Inquiry Regarding the Commission's Policy for Determining Return on Equity*, 84 Fed. Reg. 11769, 11776 (March 28, 2019) ("NOI on ROE").

[2] *Inquiry Regarding the Commission's Electric Transmission Incentives Policy*, 84 Fed. Reg. 11759, 11768 (March 28, 2019) ("NOI on Incentives").

[3] *Emera Maine v. FERC*, 854 F.3d 9 (D.C. Cir. 2017).

[4] *Ass'n of Businesses Advocating Tariff Equity Coal. of Miso Transmission Customers Illinois Indus. Energy Consumers Indiana Indus. Energy Consumers, Inc. Minnesota Large Indus. Grp. Wisconsin Indus. Energy Grp.*, 165 FERC ¶ 61,118, at P 1 (2018) ("MISO Briefing Order").

[5] *See* NOI on ROE at P 29.

[6] 16 U.S.C. § 824s.