



Ninth Circuit Creates Uncertainty Concerning Transmission ROE Adder for RTO Participation

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In a January 8 [opinion](#), the Ninth Circuit remanded the Federal Energy Regulatory Commission's (FERC) decision authorizing Pacific Gas & Electric (PG&E) to recover a 50 basis point return on equity (ROE) adder in its transmission revenue requirement for maintaining its membership in the California Independent System Operator Corporation (CAISO). FERC's action on remand bears monitoring by those utilities that recover an ROE adder for participation in a Commission-authorized regional transmission organization (RTO) or independent system operator (ISO), particularly to the extent such participation is mandated by state law.

Background

The 50 basis point ROE Adder for RTO or ISO participation (RTO Adder) has been a fixture of FERC transmission ratemaking for more than a decade, since Order No. 679 promulgated regulations implementing EAct 2005's mandate to FERC to incentivize transmission infrastructure investment, and RTO or ISO participation in particular. While FERC indicated in Order No. 679 that it was not creating a "generic adder," FERC has in practice authorized the use of the RTO Adder for virtually all transmission-owning utilities able to demonstrate that they have become or remain members of an RTO or ISO. FERC has dismissed occasional intervenor objections asserting, for example, that the RTO Adder is not needed to incentivize existing RTO or ISO members to remain in an RTO or ISO, holding that the decision to remain in an RTO or ISO is generally voluntary on the part of the transmission owner and participation in RTOs or ISOs results in benefits for organized markets and consumers. *See, e.g., Midcontinent Independent System Operator, Inc.*, 150 FERC ¶ 61,004 (2015).

The Ninth Circuit's Decision

In the instant case, the California Public Utility Commission ("CPUC") challenged FERC's award of the RTO Adder to PG&E because its participation in CAISO, according to the CPUC, is mandated by California state law. The CPUC argued that by authorizing the incentive for a transmission owner whose decision to remain a CAISO member was involuntary, FERC had effectively converted the RTO Adder into an un rebuttable "generic adder" in contravention of Order No. 679.

The Ninth Circuit held that FERC's interpretation of Order No. 679 was "plainly erroneous," and therefore not entitled to deference under the Supreme Court's *Aver* analytical framework, because it established "ongoing [RTO] membership itself as the sole criterion for receipt of the incentive adder." By failing to engage in a "case-by-case review of incentive adders even for utilities that have demonstrated ongoing membership" in RTOs or ISOs, FERC was acting in a manner inconsistent with Order No. 679's pronouncement that the RTO Adder would not be a "generic adder." Analyzing FERC's orders under the less deferential *Skidmore* standard, the Ninth Circuit concluded that "[a]warding PG&E incentive adders was a departure from FERC's longstanding policy that incentives should only be awarded to induce voluntary conduct" and "FERC also acted arbitrarily and capriciously by creating a generic adder in contravention of Order 679's requirement of case-by-case review of adders." The Ninth Circuit thus remanded the issue to FERC.

Analysis

The RTO Adder is ubiquitous in transmission owner rates in the RTO and ISO regions, and represents a not insignificant component of shareholder return. In the remand proceeding, PG&E will presumably have an opportunity to present a more robust rationale for the continued application of the RTO Adder, including evidence about the extent to which its CAISO participation is voluntary, among other factors. Beyond the implications for PG&E's rates, the remand proceeding will provide some insight into the type

of case-by-case analysis FERC may utilize in future proceedings involving the RTO Adder, and bears watching, particularly by those in areas where RTO participation may not be strictly voluntary. FERC's decision on remand may also provide clues about the newly reconstituted Commission's views on incentives for transmission investment more generally.

For more information

Van Ness Feldman represents clients on a full range of issues arising from FERC's regulation of transmission under the Federal Power Act. If you are interested in additional information regarding the Ninth Circuit's decision and its implications, please contact [Doug Smith](#), [Justin Moeller](#), or any member of the firm's [Electric](#) Practice at (202) 298-1800 in Washington, D.C. or in Seattle at (206) 623-9372.

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