

CLIENT ALERT

Ninth Circuit Rejects FERC's Grant of Incentive Adder to Public Utility in CAISO

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The United States Court of Appeals for the Ninth Circuit ruled in favor of the California Public Utilities Commission (“CPUC”) rejecting the Federal Energy Regulatory Commission’s (“FERC”) grant of incentive adders to Pacific Gas & Electric’s (“PG&E”) rate of return calculations for PG&E’s continued participation in the California Independent System Operator (“CAISO”). This ruling from the Ninth Circuit casts doubt on a public utility’s ability to include incentive adders to its rate of return calculations for participation in an independent system operator or regional transmission organization (“ISO/RTO”) if a state public utility commission either mandates continued participation or requires approval prior to withdrawal.

Background

In Order 679, FERC established “incentive adders” that a public utility could include in its rate of return on equity calculations to incentivize public utilities to participate in ISO/RTO markets. In 1998, the CPUC approved PG&E’s participation in CAISO. The CPUC also required that PG&E seek prior authorization from the CPUC before it could leave CAISO. Since 1997, PG&E’s annual section 205 (of the Federal Power Act) filings have included a 50 basis-point incentive adder for its ongoing participation in CAISO. FERC summarily granted all of PG&E’s incentive adder requests. With respect to PG&E’s 2014 and 2015 annual filings, the CPUC protested PG&E’s inclusion of the incentive adders arguing that, contrary to the requirements of Order 679, PG&E’s participation in CAISO was not voluntary but rather mandated by the CPUC. In both proceedings, FERC rejected the CPUC’s protests and summarily granted PG&E’s requested adders. The CPUC petitioned the Ninth Circuit to review the FERC orders.

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Ninth Circuit Ruling

In ruling in favor of the CPUC, the Ninth Circuit held that FERC's determination to allow PG&E to include incentive adders for its continued participation in CAISO was arbitrary and capricious because:¹

- FERC's interpretation that Order 679 allowed "summary grants of incentive adders" to public utilities that remain in ISO/RTO markets was not reasonable and "plainly erroneous and inconsistent with the regulation;"²
- Order 679 commits "FERC to case-by-case review of incentive adders even for utilities that have demonstrated ongoing membership in [ISO/RTO markets];"³
- Contrary to FERC's position, when a public utility's membership in the ISO/RTOs "is not voluntary, the incentive is presumably not justified;"⁴
- "FERC's interpretation of Order 679 is a *post hoc* rationalization of its actions;"⁵ and
- "Awarding PG&E incentive adders was a departure from FERC's longstanding policy that incentives should only be awarded to induce voluntary conduct."⁶

The court also rejected FERC's argument that the CPUC's petition is a collateral attack on Order 679 because "a reasonable party in CPUC's position would not have perceived a very substantial risk that FERC would interpret Order 679 as precluding its challenges."⁷

Future Challenges to Public Utility Annual Filings

The Ninth Circuit's decision in this case may open the door for more challenges to public utilities' rate filings that seek incentive adders for "voluntary participation" in ISO/RTO markets. It remains to be seen whether other state public utility commissions begin a wave of challenges to transmission rates that are ultimately passed on to consumers, or whether state public utility commissions revise previous orders or issue new orders that make a public utility's participation in an

¹ California Public Utilities Commission v. Federal Energy Regulatory Commission, No. 16-70481, slip op. at 11 (9th Cir. Jan. 8, 2018) ("**Decision**").

² Decision at 11 and 12.

³ Decision at 12.

⁴ Decision at 13. Notably, the Ninth Circuit declined to address PG&E and FERC's arguments that PG&E's participation in CAISO was, in fact, voluntary because these arguments were not raised in the FERC proceedings. See Decision at 21.

⁵ Decision at 15.

⁶ Decision at 20.

⁷ Decision at 23.

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ISO/RTO not “voluntary.” In contrast, transmission owners in ISO/RTO markets that have received the adder would be well advised to look for facts to distinguish the Ninth Circuit’s decision, including record support that their continued participation in an ISO/RTO market is voluntary. Alternatively, these transmission owners could consider petitioning FERC to address this issue in a generic fashion.

If you have any questions regarding this client alert, please contact the following attorneys or the attorney with whom you regularly work.

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