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Transmission Planning and Construction Right of First Refusal Ruled Unduly Discriminatory, Not Mobile-Sierra Protected

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The provision contained in incumbent electric utility tariffs—conferring on the holder the *right of first refusal (ROFR)* to construct additions to the high-voltage electrical grid, regardless of who conceived of and proposed the addition—is unduly discriminatory, the U.S. Circuit Court of Appeals for the *D.C. Circuit* held in a July 1 decision in ***Oklahoma Gas & Electric Co. v. FERC***, No. 14-1281. The court's decision upheld utility-specific applications of the FERC mandate—a central open-access innovation of the agency's Order No. 1000 (*Transmission Planning and Cost Allocation by Transmission Owning and Operating Public Utilities*)—that directed independent system operators and regional transmission organizations (ISO/RTO) to remove from their existing tariffs and membership agreements the ROFR provision (Removal Mandate).

Earlier in *South Carolina Public Service Authority v. FERC*, 762 F.3d 41 (D.C. Cir. 2014), the same court generally had upheld the Removal Mandate as applied to ISO/RTOs but had reserved judgment on whether the 60-year-old *Mobile-Sierra* presumption that the rates in negotiated arm's length natural gas and power sales agreements are just and reasonable applied to the ROFR provisions of the ISO/RTO tariffs and membership agreements. In *Sierra*, the Supreme Court of the United States held that the presumption applies against not only the parties to a negotiated agreement but against FERC itself; thus, if it were found to apply to the ROFR, FERC could overcome the presumption only by showing that the ROFR seriously harmed the public interest.

The court could have resolved ISO/RTO and incumbent utilities' challenges to the Removal Mandate in either of two ways. First, it could have determined that the context in which the ROFR provision was included in the tariffs and membership agreements prevented the presumption from applying in the first instance because of infirmities or unfair dealings in contract formation, such as fraud or duress. Second, it could determine that the presumption did apply and then address the question of whether FERC had overcome the presumption with evidence that the ROFR in member agreements seriously harmed the public interest. The court took the former course. It ruled that the *Mobile-Sierra* presumption never applied in the first instance because (quoting Order No. 1000 and citing *South Carolina*), the ROFR "created 'a *pre-existing* [*i.e.*, not negotiated] barrier to entry' for nonincumbent transmission owners." Citing precedent from the Seventh Circuit, the court found that "such terms" as the ROFR are "self-protective and anti-competitive [and] cartel-like."

By cabining its holding to the anticompetitive effects of the ROFR, the court was able to bypass two other and possibly more complicated issues. First, it bypassed the issue of whether the *Mobile-Sierra* presumption applies not only to the rates in regulated natural gas and power sales agreements, but also to agreement terms that *affect* rates. As the court noted, both the petitioners and FERC argued the case based "on the premise" that the presumption applies to both to rates and agreements terms that affect rates. Second and possibly more nettlesome is whether the *Mobile-Sierra* presumption would protect other provisions of ISO/RTO tariffs even though (quoting the court) "[t]ariffs are the mechanism through which regulated utilities *unilaterally* set their rates and terms of service," whereas *Mobile-Sierra* protects contracts negotiated bilaterally between sophisticated parties at arm's length. The court held open resolution of this issue for future unilateral challenges to other ISO/RTO tariff or member agreements.

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