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FERC Considering Major Update to Energy Infrastructure Investment Policies

26 March 2019

On March 21, 2019, the Federal Energy Regulatory Commission ("FERC") opened public inquiries into two interrelated policy areas relevant to a broad swath of energy infrastructure: electric transmission incentives and the returns on equity ("ROE") for public utilities, natural gas pipelines, and oil pipelines. Together, the proceedings provide an opportunity for a holistic review of FERC's policies in these areas, determining whether the policies are attracting the necessary level of infrastructure investment to develop a more advanced power grid.

In the first notice of inquiry, *Inquiry Regarding the Commission's Electric Transmission Incentives Policy ("Incentives Inquiry")*, 166 FERC ¶ 61,208 (2019), FERC requests stakeholder comments on the transmission incentive rules it developed in response to the Energy Policy Act of 2005 ("EPAct 2005"). That statute directed FERC to establish incentive-based rate treatments for interstate transmission to ensure reliability and reduce transmission congestion. It has been nearly 13 years since FERC initially promulgated rules in response to the EPAct 2005 directive, and over six years since its last formal policy statement on the topic. FERC now appears prepared to consider a comprehensive policy refresh.

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The *Incentives Inquiry* revisits the existing policy's foundational principle that incentives should be based on the risks and challenges associated with a proposed transmission project, asking whether incentives should instead be based on a project's benefits. The proceeding is multi-faceted, with FERC seeking comments on several issues relevant to infrastructure development, including: (1) should FERC use its incentives policy to foster cybersecurity and physical security of jurisdictional transmission facilities; (2) how should evolving transmission technologies fit into the incentives policy; (3) whether, or what types of, transmission incentives can better encourage enhancements to existing facilities; (4) should investments in transmission system resilience, as defined in FERC's separate proceeding on that topic, be eligible for incentives; and (5) the relationship between the transmission incentives policy and FERC's efforts to foster competitive transmission development.

The *Incentives Inquiry* also opens an examination of the ROE-adder incentives that FERC has established, including the incentive adders for public utilities that are structured as independent transmission companies and those that participate in organized wholesale markets. FERC requests stakeholder input on the general framework for analyzing incentives, as well as FERC's specific requirements for, level of, and design of the existing ROE adders. Importantly, the *Incentives Inquiry* also requests information about the relationship between FERC's transmission incentives policy and its policy for establishing public utilities' base ROE.

The second notice of inquiry, *Inquiry Regarding the Commission's Policy for Determining the Return on Equity for Public Utilities ("ROE Inquiry"),* 166 FERC ¶ 61,207 (2019), acknowledges that the efficacy of FERC's policy concerning public utility ROE has been called into question both as a factual matter, based on its results since the 2008 financial crisis, and as a legal matter, based on the 2017 opinion from the U.S. Court of Appeals for the D.C. Circuit in *Emera Maine v. FERC*, 854 F.3d 9 (D.C. Cir. 2016). FERC instituted the *ROE Inquiry* to seek input on potential modifications to its public utility ROE policy, including whether corresponding changes to its ROE policies for natural gas pipelines and oil pipelines are warranted.

The *ROE Inquiry* enumerates eight topics on which FERC is seeking stakeholder comments:

1. The role that FERC's determinations on base ROE plays in investment decision-making, and what objectives should guide FERC in making those determinations;
2. Whether FERC should uniformly apply its base ROE policy across the electric, interstate natural gas pipeline, and oil pipeline industries;
3. The performance of the discounted cash flow model in estimating cost of equity;

4. The composition of proxy groups used to estimate cost of equity;
5. The financial model, or combination of financial models, that FERC should use to estimate the cost of equity for purposes of establishing an ROE;
6. The mismatch between market-based ROE determinations and book-value rate base;
7. How FERC determines whether an existing ROE is unjust and unreasonable under the first prong of the Federal Power Act section 206 analysis; and
8. The mechanics and implementation of the various financial models for estimating cost of equity.

The *Incentives Inquiry* and *ROE Inquiry* each raise questions that go to the very foundation of FERC's policies in the areas at issue. Although the extent to which FERC ultimately will alter the policies at issue is unknown, the comprehensive nature of the inquiries indicates that FERC may use these proceedings to rebuild its policies in these areas from the ground up. Indeed, multiple FERC Commissioners acknowledged that prospect in their public remarks at FERC's monthly open meeting, speaking immediately before they voted to commence the inquiries. Chairman Chatterjee emphasiz ed that these orders come at "an inflection point" for the industries involved, and that the policy frameworks established through these proceedings could have ripple effects for "decades to come." These inquiries appear to be jus t the first step in what could be a very long process to modify FERC rules and policies.

For both the *Incentives Inquiry* and *ROE Inquiry*, public comments are due within 90 days of the date that the notices are published in the Federal Register, putting the likely deadline in late May or early June, with reply comments due 30 days later.

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