



FERC Seeks to Eliminate Utility Self-Funding of Network Upgrades

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On June 13, 2024, the Federal Energy Regulatory Commission (FERC or the Commission) issued an Order (the Show Cause Order) requiring PJM Interconnection, L.L.C. (PJM), Midcontinent Independent System Operator Inc. (MISO), Southwest Power Pool Inc. (SPP) and ISO New England Inc. (ISO-NE) (collectively, the Respondent RTOs) to show cause as to why their tariffs are not unjust, unreasonable and unduly discriminatory or preferential because they include provisions that provide transmission owners the right to unilaterally elect to fund the costs of network upgrades and earn a return on such funding (TO Self-Funding).¹ The Show Cause Order preliminarily finds that the TO Self-Funding option may unfairly raise costs, create barriers to entry for new generation resources and create opportunities for transmission owners to discriminate among customers.² The Show Cause Order could have a significant impact on the costs that generation resources pay to interconnect their facilities to the grid in markets operated by the Respondent RTOs.

The Show Cause Order is the most recent development in a series of legal battles stretching back to 2009 regarding whether transmission-owning utilities have a right under the Federal Power Act (FPA) to earn a return on network upgrades that they construct to accommodate the interconnection of individual generation resources. While the case will have the most direct impact on the costs of interconnection service, the Show Cause Order raises important legal and policy issues that could have implications for the continued evolution of FERC-regulated markets more generally. Perhaps reflecting the significance of the proceedings, a

group of utilities filed a request for rehearing of the Show Cause Order on July 15, 2024, arguing that it is unlawful because it seeks to compel utilities to provide service without an opportunity to earn a return in violation of the FPA and the U.S. Constitution, constitutes an unlawful delegation of legislative authority and violates the major questions doctrine and the Administrative Procedure Act.³

Each of the Respondent RTOs is required to file a response to the Show Cause Order by September 11, 2024. Interested parties will then have 30 days from the submission of the Respondent RTOs' responses to submit comments or protests.

I. Background

A. TO Self-Funding in the MISO Market

1. Elimination of Option 1 Funding

The origins of the present controversy can be traced back to a 2009 proceeding in which the Commission approved MISO's proposal to adopt participant-funding of network upgrades. Under the participant funding model, the generation resource seeking to interconnect to the grid is directly assigned the costs of upgrades needed to accommodate its interconnection. At the time, MISO's tariff included three options for funding network upgrade costs:

- *Generator Up-Front Funding*: The interconnection customer would pay for the costs of network upgrades as costs are incurred and billed to the interconnection customer.
- *Option 1 Funding*: The transmission owner could elect to require the interconnection customer to provide funding upfront for the network upgrades, reimburse the customer and impose a monthly network upgrade charge on the customer that would allow the transmission owner to recover its capital costs, operation and maintenance expenses, property taxes, overhead and a rate of return.
- *TO Self-Funding*: The transmission owner could elect to provide initial funding for the network upgrade costs supported by security posted by the interconnection customer, with the transmission owner subsequently recovering the capital costs over time through a network upgrade charge that includes a rate of return.

In 2011, however, FERC granted a complaint filed by generation developers challenging Option 1 Funding as unjust, unreasonable and unduly discriminatory and directed MISO to remove

Option 1 Funding from its tariff.⁴ In granting the complaint, the Commission agreed with the generation developers that Option 1 Funding increased the costs borne by interconnection customers by allowing the transmission owner to recover a return and other expenses directly from the interconnection customer. The Commission also expressed concern that a transmission owner could use its discretion to select funding options to favor certain interconnection customers (e.g., affiliated generation resources) while increasing the costs for competing generation resources. The Commission thus directed MISO to revise its tariff to eliminate Option 1 Funding for interconnection-related agreements beginning on March 22, 2011.

Although transmission owners continued to have the option to elect TO Self-Funding, FERC limited network upgrade charges imposed under this option to the capital costs, plus a rate of return, on the undepreciated portion of the network upgrades. Additionally, while transmission owners to which a customer directly interconnected could elect TO Self-Funding, transmission owners constructing network upgrades elsewhere on the MISO system—referred to as affected system operators—could not.

2. Challenges to TO Self-Funding

In 2014, FERC granted in part, and rejected in part, a complaint challenging MISO's *pro forma* network upgrade funding policy as unjust and unreasonable because it did not afford affected system operators the right to elect TO Self-Funding.⁵ Notably, while the Commission found that the same funding options should be available to all interconnection customers and transmission owners, it preliminarily found that interconnection customers—rather than transmission owners—should have the right to select the financing mechanism. Like in its earlier decision eliminating Option 1 Funding, the Commission expressed concern that allowing transmission owners to unilaterally elect to fund network upgrades could create opportunities for undue discrimination and deprive customers of other options to finance the cost of network upgrades on more favorable terms and rates. The Commission further found that a transmission owners unilateral election to initially fund network upgrades could increase the costs of interconnection service by assigning increased costs to customers without any increase in the service provided. After providing MISO and other parties the ability to comment on the issues raised by the Commission's order, the Commission directed MISO to revise its *pro forma* generator interconnection agreement and facilities construction agreement to permit TO Self-Funding only upon the mutual agreement of the customer and transmission owner.

In January 2018, in response to petitions filed by certain transmission owners challenging the Commission's orders, the U.S. Court of Appeals for the D.C. Circuit vacated the Commission's orders and remanded the case for further proceedings before the agency.⁶ The court found that the Commission's finding that TO Self-Funding may create opportunities for undue discrimination was unsupported by evidence or economic theory. In particular, the court noted that only one of the transmission companies appealing the Commission's orders still owned a generation resource. Although the court acknowledged that "FERC is not obliged to show actual evidence to support a determination of potential discrimination, . . . in the absence of evidence, the Commission must at least rest on economic theory and logic" and "that is lacking here."⁷

The court further found that FERC had failed to adequately consider arguments that the Commission's orders would force transmission owners to incur additional risks without compensation and that FERC's decision would require transmission owners to "act, at least in part, as a non-profit business."⁸ While FERC had emphasized that TO Self-Funding would increase costs and security requirements and that transmission owners did not have any right to require interconnection customers to finance their network upgrades through them, the court noted that an interconnection customer likely would have to provide security to a third-party financing source. The court also found that the Commission had not made any attempt to assess the various risks imposed on transmission owners by the addition of network upgrades, including the risk that these entities would be required to incur additional insurance and litigation costs. The court also rejected FERC's argument that transmission owners should be denied the opportunity to earn a return on these investments:

FERC seems to believe that transmission owners are simply not entitled to participate in funding the network upgrades, and importantly, to earn a return on capital. . . . But a careful reading of Supreme Court precedent reveals that a regulated industry is entitled to a return that is sufficient to ensure that new capital can be attracted. Therefore, as we have often said, a utility's return must allow it to compete for funding in the financial markets. Investors, however, invest in entire enterprises, not just portions thereof. FERC must explain how investors could be expected to underwrite the prospect of potentially large non-profit appendages with no compensatory incremental return. It is certainly true, as the transmission owners note, that the answer FERC offered—to cajole consent from the generators—is a *non sequitur*.⁹

On August 31, 2018, the Commission issued an order on remand reversing its prior determination that transmission owners and affected system operators should not be given the unilateral right to elect to provide initial funding for network upgrades.¹⁰ While the D.C. Circuit's decision had left open the possibility that the Commission could articulate a reasonable basis for eliminating TO Self-Funding after further developing a record on remand, the Commission's order largely found that its prior determination had not been adequately supported and thus, should be reversed. Accordingly, the Commission directed MISO to submit a compliance filing revising its *pro forma* generator interconnection agreement, facilities construction agreement and multi-party facilities construction agreement to reinstate the right of a transmission owner to unilaterally elect the TO Self-Funding option prospectively from the date of the Commission's order.

The Commission also held that generator interconnection agreements, facilities construction agreements and multiparty facilities construction agreements "entered into between June 24, 2015 [i.e., the date of the complaint] and August 31, 2018 should be revised to allow transmission owners . . . to unilaterally elect to provide initial funding for network upgrades, if they so choose."¹¹ This provided transmission owners that entered into agreements during this period the ability to modify the terms of their agreements to include TO Self-Funding after-the-fact. In a subsequent compliance filing, MISO identified approximately 20 agreements entered into during this period in which transmission owners elected to revise the agreements to incorporate TO Self-Funding.¹²

The American Clean Power Association (ACP) and certain other generation developers subsequently filed a petition with the D.C. Circuit challenging the Commission's orders on remand. They argued that the Commission erred in failing to follow the court's directive to develop a record and that it was arbitrary and capricious for the Commission to give transmission owners the unilateral authority to fund power line upgrades.¹³ In December 2022, the court rejected arguments that FERC was required to engage in any particular type of briefing on remand, but agreed with petitioners that FERC had failed to meaningfully consider arguments that transmission owners within MISO continue to own generation resources and, thus, would have an incentive to engage in undue discrimination. The court noted that FERC's orders on remand had found that any potential discrimination concerns did not outweigh the transmission owners' enterprise-risk concerns and that customers could challenge the costs allocated to their projects before FERC. Nevertheless, the court found the Commission's reasoning lacking because FERC had failed to provide "an assessment of the risk of

discrimination and an explanation of why individualized proceedings provide generators with sufficient protection against that risk.”¹⁴ Accordingly, the court remanded the Commission’s orders back to FERC to provide the agency an opportunity to further explain its decision. That remand remains pending before the Commission.

3. Developments in Other Markets

While litigation around the issue of TO Self-Funding has largely focused on MISO, MISO is not the only RTO or independent system operator (“ISO”) that provides transmission owners with this funding option. The tariffs of ISO-NE and SPP have included a TO Self-Funding option since 2004 and 2009, respectively. Additionally, in the wake of the Commission’s decision on remand in the *Ameren* case, PJM, on behalf of the PJM transmission owners, made a filing proposing to revise its tariff to permit TO Self-Funding. On November 19, 2021, the Commission issued an order accepting and suspending the filing for five months and established paper hearing procedures to develop a further record concerning TO Self-Funding, including the risks posed by network upgrades and the impact of generator funding on the ability of transmission owners to attract capital.¹⁵ That proceeding remains pending before the Commission.

During this same period, the Commission denied a complaint filed by the New York transmission owners arguing that the NYISO tariff was unjust and unreasonable because it failed to compensate transmission owners for the risks and costs associated with owning, operating and maintaining system upgrades.¹⁶ The Commission found that the New York transmission owners had failed to show that existing funding mechanisms exposed them to uncompensated risks or impeded their ability to attract capital. The Commission added that the manner in which a utility’s return on equity is established ensures that utilities are compensated for enterprise risks, including those associated with the construction of network upgrades.

II. The Show Cause Order

In the Show Cause Order, the Commission preliminarily finds that the existing tariffs of MISO, PJM, SPP and ISO-NE are unjust and unreasonable because they include a TO Self-Funding option. According to the Commission, the ability to elect to self-fund network upgrades increases the costs of interconnection service without improvements to that service and may do so in a manner that raises barriers to entry and creates opportunities for undue discrimination. At the same time, the Commission preliminarily finds that there “may be no

risks associated with owning, operating, and maintaining network upgrades for which transmission owners are not already otherwise compensated.”¹⁷

The Commission cites comments filed in other dockets involving TO Self-Funding demonstrating that this option increases costs by charging customers a return that is higher than the costs they would pay to finance network upgrade costs on their own and requiring interconnection customers to post security on the undepreciated balance of the network upgrade costs. The Show Cause Order also expresses concern that transmission owners may use TO Self-Funding to increase costs for unaffiliated generation resources, noting that following the remand in *Ameren*, certain MISO transmission owners sought to only reopen agreements for unaffiliated resources while leaving intact agreements for their affiliates’ generation resources.¹⁸ The Show Cause Order finds that transmission owners may not face risks associated with owning, operating and maintaining network upgrades for which they are not already compensated under their existing transmission rates. The Commission adds that there is no evidence that the lack of a return on interconnection-related network upgrades poses risks to transmission owners’ businesses or prevents them from attracting the capital necessary to operate. The Commission explains that a utility’s return on equity is calculated based on the risk profile of the enterprise as a whole and, thus, any Commission-approved return on equity will incorporate any enterprise-wide risks posed by network upgrades.

For the foregoing reasons, the Show Cause Order directs each Respondent RTO to make a filing within 90 days of the order showing cause as to why its tariffs remain just and reasonable and not unduly discriminatory or preferential or explain what changes would be necessary to make their tariffs just and reasonable. The Show Cause Order also provides the Respondent RTOs the flexibility to propose tariff revisions under Section 205 of the FPA to resolve the issues identified in the order. The order grants interested parties the right to submit comments on the issues raised by the Show Cause Order within 30 days of each Respondent’s RTO’s show cause response.

Notably, concurrently with the issuance of the Show Cause Order, the Commission issued an order providing notice that it will hold in abeyance any further proceedings related to the D.C. Circuit’s latest remand of the MISO TO Self-Funding orders.¹⁹

III. Implications

The outcome of the proceedings established by the Show Cause Order could have significant implications for how transmission expansions are funded in RTO/ISO markets. It is no secret that the costs of network upgrades have increased dramatically in recent years due to a combination of factors, including a marked increase in the demand for interconnection service and the relatively limited amount of investment occurring through regional and interregional planning efforts. Indeed, the Commission cited ballooning network upgrade costs as a factor supporting the Commission's decision in Order No. 1920 to direct transmission providers to amend their tariffs to include long-term transmission planning:

The record demonstrates that significant expansion of the transmission system is occurring through one-off, piecemeal, interconnection-related network upgrades constructed in response to individual generator interconnection requests. As the Commission observed in the [Notice of Proposed Rulemaking ("NOPR")], the evidence shows a sharp growth in both the total cost of interconnection-related network upgrades and in the cost of such upgrades relative to generation project costs. The record indicates that the average cost of interconnection-related network upgrades is increasing over time as the transmission system is fully subscribed and demand for interconnection service outpaces transmission investment. As highlighted in the NOPR, in 2020, MISO identified the need for nearly \$2.5 billion in interconnection-related network upgrades to interconnect just 9.2 GW of generation in MISO South, and MISO expects to need over \$3 billion in interconnection related network upgrades for interconnection in MISO West. Similarly, SPP identified the need for \$4.6 billion in interconnection-related network upgrades to interconnect just 10.4 GW of new generation.²⁰

A determination by the Commission to eliminate TO Self-Funding would mean that transmission owners no longer would have the unilateral right to assume the costs of these upgrades and then recover the costs of these upgrades, plus a rate of return, from interconnection customers. For customers in MISO whose agreements were renegotiated following remand in the *Ameren* case to incorporate TO Self-Funding, the Show Cause Order raises the prospect that FERC may again reverse itself and perhaps provide customers with the ability to revert to their initial funding frameworks and obtain refunds. Conversely, a decision by the Commission to permit TO Self-Funding would mean that interconnection customers would be required to pay the costs of these network upgrades over time (e.g., over a 20-year period), potentially with the result that customers would pay more than if they had simply paid the costs of these upgrades upfront.

The debate around TO Self-Funding also raises an important legal issue that may have implications beyond how network upgrades are funded: whether the FPA provides public utilities with the right to earn a return on the investments that they make in connection with providing FERC-jurisdictional interconnection service. One of the main arguments raised by parties supporting TO Self-Funding is that allowing interconnection customers to pay the costs of network upgrades upfront results in confiscatory rates by forcing transmission owners to provide interconnection service and incur its associated risks without the opportunity to earn a return on network upgrade costs in violation of both the FPA and the U.S. Constitution. Thus, resolution of the Show Cause Orders could set an important precedent regarding the extent to which public utilities are entitled to earn a return on each of the services that they provide.

At a time when FERC has taken the position that public utilities can be compelled to provide certain services without compensation, FERC's determinations in the resolution of the issues raised by the Show Cause Order.

¹ *Midcontinent Ind. Sys. Operator, Inc.*, 187 FERC ¶ 61,170 at P 1 (2024).

² *Id.*

³ *Midcontinent Indep. Sys. Operator, Inc., et al.*, Request for Rehearing of the Indicated Utilities, Docket Nos. EL24-80-001, *et al.* (filed July 15, 2024).

⁴ *E.ON Climate & Renewables N. Am., LLC v. Midwest Indep. Transmission Sys. Operator, Inc.*, 137 FERC ¶ 61,076 (2011), *reh'g denied*, 142 FERC ¶ 61,048 (2013), *reh'g denied*, 151 FERC ¶ 61,264 (2015).

⁵ *Midcontinent Indep. Sys. Operator, Inc.*, 151 FERC ¶ 61,220 (2015).

⁶ *Ameren Servs. Co. v. FERC*, 880 F.3d 571 (D.C. Cir. 2018) (“*Ameren*”).

⁷ *Id.* at 578.

⁸ *Id.* at 581.

⁹ *Id.*

10 *Midcontinent Indep. Sys. Operator, Inc.*, 164 FERC ¶ 61,158 (2018).

11 *Midcontinent Indep. Sys. Operator, Inc.*, 169 FERC ¶ 61,233 at P 1 (2019).

12 *Midcontinent Indep. Sys. Operator, Inc.*, Compliance Filing, Docket No. ER18-2513-003, Tab C (filed Feb. 18, 2020).

13 ACP also argued that FERC had acted inappropriately by permitting retroactive modification of agreements that had been entered into between June 24, 2015, and August 31, 2018. The court, however, found that it did not have jurisdiction to consider these arguments because they had not been raised on rehearing of the Commission's orders. *Am. Clean Power Ass'n v. FERC*, 54 F.4th 722, 725 (2022).

14 *Id.* at 727.

15 *PPL Elec. Utils. Corp.*, 177 FERC ¶ 61,123 (2021).

16 *Cent. Hudson Gas & Elec. Corp. v. N.Y. Indep. Sys. Operator, Inc.*, 176 FERC ¶ 61,149 (2021), *order on reh'g*, 178 FERC ¶ 61,194 (2022).

17 Show Cause Order at P 1.

18 *Id.* at P 52.

19 *Midcontinent Indep. Sys. Operator, Inc.*, Notice to Hold Proceeding in Abeyance, Docket Nos. EL15-68-003, *et al.* (June 13, 2024).

20 *Building for the Future Through Elec. Reg'l Transmission Planning & Cost Allocation*, Order No. 1920, 187 FERC ¶ 61,068 at P 104 (2024) (footnotes omitted), *appeals pending*.

Categories

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