

Right of First Refusal (“ROFR”) in New Mexico

Background

Historically, public utilities have had the right of first refusal (that is, first choice) in deciding whether to construct and operate transmission line projects approved for construction within their service areas by a regional transmission planning authority such as the Southwest Power Pool (“SPP”) or the Western Electric Coordinating Council (“WECC”). The right of first refusal is a long-standing policy, a necessary trade-off public utilities received in exchange for maintaining the transmission grid’s efficiency and reliability.

The protocols governing wholesale transmission activities (such as approving transmission projects for construction, coordinating the operation of the transmission grid, and ensuring reliability) and the rates for wholesale transmission services are set out in tariffs approved by the Federal Energy Regulatory Commission (“FERC”).

In July, 2011, the Federal Energy Regulatory Commission changed the status quo by striking from any FERC-approved tariff the provisions that historically have given public utilities the right of first refusal to construct and operate transmission projects approved for construction by a regional transmission planning authority. The Federal Energy Regulatory Commission made it clear, however, that it will defer to state policy on the right of first refusal issue (that is, FERC will not preempt a state law that allows a right of first refusal).

A brief review of federal transmission policy may be helpful to understand the inequity of the Federal Energy Regulatory Commission’s action. In 1992, Congress passed the Energy Policy Act, which required that Public Utilities provide access to their transmission systems to others on the same terms and conditions they provide to themselves. This policy is referred to as open-access transmission.

The Federal Energy Regulatory Commission implemented the Energy Policy Act by adopting rules and issuing various orders. One of those actions, Order 888, is a landmark decision, which required public utilities to file open access transmission tariffs and created rules ensuring that companies that own both generation and transmission do not have an unfair advantage over independent generators in seeking access to the transmission grid. Over time, the Federal Energy Regulatory Commission encouraged public utilities to join regional transmission authorities such as the Southwest Power Pool to ensure the development of a robust wholesale electricity market.

Southwestern Public Service Company is a member of the Southwest Power Pool. The Southwest Power Pool controls access to the transmission facilities owned by its members and facilitates a thorough transmission planning process

that identifies new transmission projects needed for reliability and to handle new load. The Southwest Power Pool coordinates the operation of SPS's transmission facilities and the operations of the other Southwest Power Pool members that own transmission facilities. As part of the FERC-approved contractual agreements between the utilities (such as SPS) and the Southwest Power Pool, the utilities were guaranteed a right of first refusal to construct and operate transmission lines that interconnect with their existing transmission lines.

Public utilities such as Southwestern Public Service Company have a legal obligation to serve the public. In light of this obligation, and because of the good faith coordination of its transmission facilities with the Southwest Power Pool, public utilities should have the right of first refusal to construct and operate transmission projects approved for construction by the Southwest Power Pool that interconnect with their transmission systems.

Legislative Proposal

The legislation proposed by Southwestern Public Service Company will provide an ordered coordination of how future transmission lines in New Mexico will be built. Under the legislation, after a regional transmission planning authority conducts an open planning process and determines that a new transmission line should be built, the incumbent utility that owns an endpoint substation (such as SPS, PNM, or EPE) is given the first chance to announce its intention to construct, own, and maintain the line. If the incumbent utility does not decide to build the line within 120 days, then another entity may seek to build the line.

Why is this legislation necessary?

First, the legislation avoids serious disruption to the current New Mexico state regulatory oversight structure. Essentially, without the legislation, a federal regulator gets to decide who gets to build a transmission line and how much to charge for it. In addition, New Mexico utilities would have to rely on a non-utility to fulfill their own obligation to serve New Mexico customers. When the lights go out, it is still the incumbent New Mexico utility that has the obligation to serve. But without a right of first refusal, New Mexico utilities will still have the obligation to serve, but wouldn't own portions of the transmission system. Thus, critical decisions on transmission operations and costs will shift from the Public Regulation Commission to the Federal Energy Regulatory Commission.

Second, the legislation maintains New Mexico's control over the quality of transmission service to New Mexico customers. New Mexico utilities have an obligation under state law to serve our customers. If utilities are not allowed to build, own, operate, and maintain the critical infrastructure needed to fulfill that obligation, we cannot be held responsible for outages caused by transmission

failures. Currently the integrity of the system is up to the utilities that are regulated by the Public Regulation Commission. Plus, local New Mexico utilities use decades of experience building and maintaining transmission lines in New Mexico to develop standards that are specific to the region's climate. Without a right of first refusal, the integrity of the system could be left to non-utility companies that are regulated in Washington DC.

Third, the cost for transmission lines will be lower if a New Mexico utility builds the transmission lines. Without the right of first refusal, transmission costs will be set by the Federal Energy Regulatory Commission under a federal rate tariff that will then be imposed on New Mexico's energy consumers. Typically, those federal tariffs have included higher rates of return than are allowed to New Mexico utilities. With ownership of the transmission lines staying with New Mexico's utilities, the rate of return will be controlled by the Public Regulation Commission through the rate process.