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# RIGHT OF FIRST REFUSAL LAWS FOR ELECTRIC TRANSMISSION ARE ANTI-COMPETITIVE IN INTERSTATE COMMERCE

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## FEDERAL PRE-EMPTION IS APPROPRIATE

The benefits of competition in building and operating new electric transmission projects is increasingly apparent. A recent study by the [Brattle Group](#) found that the winning bids in competitive transmission projects were 40 percent below the initial cost estimate for the project.

According to data from the Energy Information Agency, annual spending on the electric transmission system by major U.S. utilities has grown from \$15 billion in 2005 to nearly \$40 billion annually, with the majority of these costs coming from new investments. Various studies place the cost of transmission investment in the range of hundreds of billions to trillions of dollars to meet decarbonization goals over the next two decades. Transmission competition could save tens to hundreds of billions of dollars over this period.

## ROFR REQUIREMENTS BLOCK COMPETITION

Barriers to competition for electric transmission are high and still increasing in some parts of the country. Chief among these are so-called Right of First Refusal (ROFR) requirements for new transmission projects. Under a ROFR system, incumbent utilities have the exclusive right to build, maintain and own transmission lines located within their service territory. Only if the utility declines would the project be subject to competitive bidding.

In 2011, the Federal Energy Regulatory Commission (FERC) repealed federal ROFR requirements in its Order 1000. Order 1000, however, applied only to federal projects—local projects, for example, were exempted. In addition, Order 1000 did not prohibit states from enacting their own ROFR requirements.

Order 1000 has had less of an effect than was originally hoped. Since the order went into effect, only 3 percent of new transmission investment in the United States has been subject to competition.

A major reason for this limited impact has been the expansion of state ROFR requirements. Since Order 1000, a number of states, including Iowa, Minnesota, North Dakota, South Dakota and Texas, have enacted their own ROFR requirements for electric transmission. New ROFR laws have tended to pop up in states with high concentrations of new wind power, which can require significant new transmission builds to accommodate. These laws also inhibit the construction of large, multi-state projects as utilities in states with a ROFR law break the project into smaller pieces in order to comply with that law.

## LEGAL CHALLENGES TO STATE ROFR REQUIREMENTS

In two states—Texas and Minnesota—the enactment of ROFR statutes has led to litigation. These cases involved the Dormant Commerce Clause, which is a doctrine that prevents states from passing laws that discriminate against or unduly burden interstate commerce. The lawsuits alleged that by limiting transmission projects to incumbents—who are of necessity in-state—the laws discriminated against out-of-state transmission companies.

Dormant Commerce Clause cases are difficult to win, because courts are wary to second guess the judgments of states in this area. As of this piece, the Minnesota lawsuit has been rejected by the federal Eighth Circuit Court of Appeals, while the Texas lawsuit remains pending before the Fifth Circuit Court of Appeals. The

Eighth Circuit decision stressed the broad latitude courts give to states in choosing a regulatory model for electric utilities, as well as the fact that some of the incumbent transmission companies had headquarters outside of the state. It did not evaluate the economic costs of ROFR or the potential for interstate cost-shifting as such.

Even if these court challenges prove unsuccessful, action on this issue by other branches of the government, including FERC, is not precluded. FERC retains the authority to expand or modify Order 1000 in response to developing events or the intransigence of states.

## **ROFR IS IMPORTANT FOR CLEAN ENERGY AND IS NOT JUST A STATE MATTER**

State ROFR laws can have implications for consumers outside the state. For example, in the Minnesota ROFR litigation, the Iowa Office of Consumer Advocate, a division of the Iowa Department of Justice concerned with consumer protection issues, filed an amicus brief in support of the challenge.<sup>1</sup> As noted in the brief, some transmission projects subject to the Minnesota ROFR are regional projects that are partially paid for by electric consumers outside the state. The use of a ROFR requirement by one state can therefore impose costs on other states, contrary to the spirit of federalism.

Conflicts between states over ROFR have the potential to delay or discourage much-needed transmission buildouts. Some states, such as Illinois, have begun to resist the idea of paying for regionally cost allocated transmission projects because other states' ROFR laws cause inflated costs. Similarly, independent electricity market monitors and consumer groups voice concerns over transmission expansion given the rising costs tied to ROFR and other anti-competitive practices. Many consumers have seen their transmission costs more than double in the last five years, whereas consumers in the PJM Interconnection now pay more for transmission capacity than generation capacity. Simply scaling up the status quo or, worse, letting ROFR proliferate further, is not sustainable and will prompt a consumer backlash.

The rising costs of ROFR make interstate transmission projects more controversial and prone to delays. This risks stifling the investment essential to the clean energy transition. Already, the transmission system is woefully short of the capacity needed to meet ambitious clean energy goals, which are becoming a priority at both the federal and state level, as well as in the private sector. Because of the geography of clean energy resources, meeting these goals will require substantial new builds of interstate transmission throughout the country.

Major delays for these projects will make meeting planned goals and timelines all but impossible. If states are allowed to effectively shift higher costs for transmission builds onto ratepayers in other states, conflict is inevitable. Ultimately, a federal resolution of this matter is needed to ensure that consumers in all states are treated fairly and that costs are kept low. Corrective options for FERC include preempting ROFR laws or changing the regulatory presumption of prudence for transmission projects subject to ROFR. Given state sensitivities on the subject, FERC could convene stakeholders to explore conflict resolution options and chart a course towards pro-competition transmission reform.

## **CONTACT US**

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1. This occurred prior to the passage of Iowa's own ROFR in 2020.