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FERC Allows Merchant and Nonincumbent Participant-Funded Transmission Developers to Allocate 100% of Capacity Through Bilateral Negotiations

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On January 17, 2013, the Federal Energy Regulatory Commission (FERC) issued a Final Policy Statement (Policy Statement) that permits the developers of new merchant transmission projects and new nonincumbent, cost-based, participant-funded transmission projects to allocate 100% of a project's capacity through bilateral negotiations instead of an open season, subject to certain conditions.

BACKGROUND

FERC utilizes a four-factor analysis to evaluate a request by a merchant transmission developer for negotiated rate authority: (1) the justness and reasonableness of rates; (2) the potential for undue discrimination; (3) the potential for undue preference; and (4) regional reliability and operational efficiency requirements. Prior to the Policy Statement, FERC required developers to conduct an open season to allocate a portion of the available capacity on a project, and to subsequently file a report with FERC describing the results of the open season. Under this policy, FERC granted requests to allocate up to 75% of a transmission project's capacity to anchor customers outside of the open season process.

On July 19, 2012, following a series of technical conferences and filings regarding capacity allocation policies, FERC solicited comments on a proposed policy statement that would permit developers of merchant and nonincumbent, participant-funded transmission projects to allocate 100% of a project's available capacity through bilateral negotiations, provided the developer complies with certain solicitation and reporting requirements. The proposed policy changes have largely been adopted in the Policy Statement.

THE POLICY STATEMENT

Merchant Transmission Projects

In the Policy Statement, FERC allows merchant developers seeking negotiated rate authority to demonstrate compliance with the second (undue discrimination) and third (undue preference) prongs of the four-factor analysis by following the Policy Statement's guidelines for an open customer solicitation process and for reporting the capacity allocations resulting from bilateral negotiations.

Open Solicitation Process

Under the Policy Statement, transmission developers may now engage in an open solicitation of interest in their projects from potential transmission customers in lieu of conducting an open season. The open solicitation must include a broad notice to ensure that all potential and interested customers are informed of the proposed project, and must include pertinent project dates, contract details, and sufficient technical specifications to inform interested customers of the nature of the project.

Once a subset of customers has been identified through the open solicitation, FERC will allow developers to engage in bilateral negotiations with each potential customer. Such negotiations may result in distinctions among prospective customers based on transparent and not unduly discriminatory or preferential criteria, with the potential result that a single customer, including an affiliate of the developer, may be awarded up to 100% of the project's capacity.

Reporting Requirements

The Policy Statement requires a merchant developer to obtain FERC approval of its capacity allocation process through the filing of a post-selection demonstration. Unlike the open season report filed under FERC's prior transmission capacity allocation policy, the post-selection demonstration will be noticed for comments and protests and FERC will issue an order on it under section 205 of the Federal Power Act. Under the Policy Statement, the developer will be required to demonstrate that the process that led to the identification of transmission customers and the execution of the relevant contractual arrangements is consistent with FERC's open access policies. The post-selection demonstration must include, at a minimum:

(1) Steps the developer took to provide broad notice, including the project information and customer evaluation criteria that were relayed in the broad notice.

(2) Identity of the parties that expressed interest in the project, placed bids for project capacity, and/or purchased capacity; and the capacity amounts, terms, and prices involved in that interest, bid, or purchase.

(3) Basis for the developer's decision to prorate, or not to prorate, capacity, if a proposed project is oversubscribed.

(4) Basis for the developer's decision not to increase capacity for a proposed project if it is oversubscribed (including the details of the economic, technical, or financial infeasibility that is the basis for declining to increase capacity).

(5) Justification for offering more favorable rates, terms, and conditions to certain customers, such as "first movers" or those willing to take on greater project risk-sharing.

(6) Criteria used for distinguishing customers and the method used for evaluating bids. This should include the details of how each potential transmission customer was evaluated and

compared to other potential transmission customers, both at the early stage of identifying a subset of customers for bilateral negotiations and subsequently when the developer awards transmission capacity.

(7) Explanation of decisions used to select and reject specific customers. In particular, the report should identify the facts, including any rates, terms or conditions of agreements unique to individual customers that led to their selection, and relevant information about other potential customers that led to their rejection. If a selected customer is an affiliate, FERC will look more carefully at the basis for reaching that determination.

In the case of capacity allocations to affiliates, FERC will require a strong affirmative showing from the developer that the affiliate was not afforded an undue preference.

The Policy Statement permits developers to seek approval of the capacity allocation approach after having already completed the process of selecting customers. Alternatively, developers can first seek approval of their capacity allocation approach, and then demonstrate in a compliance filing that the selection of customers was consistent with the approved selection process. Under either procedural framework, FERC will notice the filing, allow protests, and reach a determination regarding whether the selection of customers was consistent with the Policy Statement and FERC's open access policies.

Incumbent and Nonincumbent, Cost-Based, Participant-Funded Projects

FERC will apply the capacity allocation policies contained in the Policy Statement to nonincumbent, cost-based, participant-funded transmission projects. FERC will, however, "review the transmission rate, terms, and conditions, including any agreed upon return on equity, more closely to ensure that they satisfy Commission precedent regarding cost-based transmission service."

The Policy Statement does not change the current case-by-case evaluation process for incumbent-developed, participant-funded projects.

IMPLICATIONS

The Policy Statement will afford merchant transmission developers flexibility to allocate up to 100% of the available capacity of a project through bilateral negotiations to a single customer or even to an affiliate. This added flexibility will ease development hurdles faced by merchant projects by providing greater investment certainty and creating the opportunity for strategic partnerships earlier in the development process. Fully allocating a merchant line's capacity through bilateral negotiation is likely to become standard industry practice in the wake of the Policy Statement. Merchant developers that have already been granted negotiated rate authority, but wish to utilize the Policy Statement's capacity allocation process, must first seek Commission approval.

FOR ADDITIONAL INFORMATION

For additional information, please contact Jay Ryan, Vincenzo Franco, Justin Moeller, or any member of the firm's Electric Practice at (202) 298 – 1800 in Washington, D.C. or in Seattle at (206) 623 – 9372. Follow Van Ness Feldman's Electric Practice on Twitter: http://twitter.com/VNFelectric.

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