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Practice Group(s):

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FERC Issues Final Policy Statement Permitting Developers to Allocate 100% of the Capacity for New Transmission Projects through Bilateral Negotiations

By Andrew B. Young

The Federal Energy Regulatory Commission ("FERC") has issued a Final Policy Statement to clarify and refine its policies governing the allocation of capacity for new transmission projects.[1] FERC examines four factors in evaluating requests by merchant transmission developers for negotiated rate authority: (1) the justness and reasonableness of rates; (2) the potential for undue discrimination; (3) the potential for undue preferences, including affiliate preference; and (4) regional reliability and operational efficiency requirements.[2] When analyzing the second and third factors, FERC previously relied upon a formal "open season" process to ensure against undue discrimination and preference in the allocation of new transmission capacity. However, in the *Policy Statement*, FERC announced that bilateral negotiations, if conducted in a transparent manner, may serve the same purpose as an open season process to ensure against undue discrimination or preference. As a result, FERC will allow merchant transmission developers to allocate up to 100 percent of their project's capacity through bilateral negotiations if the developer: (1) broadly solicits interest in the project from potential customers and (2) demonstrates to FERC that the developer has satisfied the solicitation, selection and negotiation process criteria set forth below.[3]

Open Solicitation Process

With respect to the first requirement, FERC indicated that a merchant transmission developer should issue a broad notice in a manner that ensures that all potentially interested customers are informed of the proposed project. FERC mentioned various methods of ensuring a broad notice, including placement in trade magazines or regional energy publications, communications with regional transmission planning groups, and transmission-related e-mail distribution lists.[4] FERC also specified that the notice should include points of contact and pertinent project dates, as well as sufficient technical specifications and contract information to inform interested customers of the nature of the project, including project size/capacity (*i.e.*, MW and/or kV rating), end points of the line (as specific as possible), projected construction and/or in-service dates, type of line (*e.g.*, AC, DC or bidirectional), precedent agreement (if developed), and other capacity allocation arrangements.[5] FERC further indicated that the developer should place in the notice the criteria it plans to use to select transmission customers, such as credit rating, "first mover" status (*i.e.*, customers who respond

[1] *Allocation of Capacity on New Merchant Transmission Projects and New Cost-Based, Participant-Funded Transmission Projects; Priority Rights to New Participant-Funded Transmission*, 142 FERC ¶ 61,038 (issued Jan. 17, 2013) (*"Policy Statement"*).

[2] *See Chinook Power Transmission, LLC*, 126 FERC ¶ 61,134, at P 37 (2009).

[3] *Policy Statement* at P 16.

[4] *Id.* at P 23.

[5] *Id.* at P 24.

early and take on greater risk), and the willingness of the customer to incorporate risk-sharing into its contracts.[6] However, FERC noted that the selection criteria and notice methods that it had offered are neither exhaustive nor prescriptive. Finally, FERC expects the merchant transmission developer to update its posting if there are any material changes to the nature of the project or status of the capacity allocation process, in particular to ensure that interested entities are informed of any remaining available capacity.[7]

FERC recognizes that merchant transmission developers and potential customers may need to negotiate individualized terms that meet their unique, project-specific needs. Therefore, once a subset of customers has been identified by the developer through the open solicitation process, FERC will allow developers to engage in bilateral negotiations with each potential customer on the specific rates, terms and conditions for procuring transmission capacity. In these negotiations, FERC will permit 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, may be awarded up to 100 percent of the transmission capacity. For example, FERC specifically mentioned that developers might offer "first mover" customers more favorable rates, terms and conditions than later customers. FERC's announcement represents a change in policy since previously FERC required developers to offer the same deal in the open season to any other customer willing to make the same commitments as an "anchor" customer.[8]

Post-Selection Demonstration

For the second requirement, FERC will require merchant transmission developers to disclose the results of their capacity allocation process through a post-selection report that will be noticed and become part of the Commission's record for approval under Section 205 of the Federal Power Act.[9] In this post-selection demonstration, FERC expects that the developer will include, at a minimum, the following information: (1) steps the developer took to provide broad notice; (2) identity of the parties that expressed interest in the project; (3) basis for the developer's decision to prorate, or not prorate, capacity; (4) basis for the developer's decision not to increase capacity for a proposed project; (5) justification for offering more favorable rates, terms and conditions to certain customers; (6) criteria used for distinguishing customers and the method used for evaluating bids; and (7) explanation of decisions to select and reject specific customers.[10]

FERC believes that the reporting obligation offers sufficient protections to ensure against undue discrimination or preference in the capacity allocation process. However, FERC also believes transparency is essential to allowing capacity to be allocated through bilateral negotiations rather than a more formally structured open season process, so requests for confidential treatment of commercially sensitive information will be reviewed on a case-by-case basis.[11] With respect to potential affiliate participation in the capacity allocation process, FERC noted that developers will bear a high burden to demonstrate that the assignment of capacity to their affiliates, and the corresponding treatment of non-affiliated potential customers, is just and reasonable, and not unduly discriminatory or preferential. Thus, FERC indicated that it will carefully scrutinize any differences

[6] *Id.* at P 25.
[7] *Id.* at P 27.
[8] *Id.* at P 28.
[9] 16 U.S.C. 824d.
[10] *Policy Statement* at P 30.
[11] *Id.* at P 33.

in rates, terms and conditions for affiliates as against non-affiliates to ensure those differences are appropriately based on objective criteria.[12]

FERC will permit developers to seek approval of their capacity allocation approach after having completed the process of selecting customers. Alternatively, the developer can first seek FERC's approval of the developer's capacity allocation approach, and then demonstrate in a compliance filing that its selection of customers was consistent with the approved selection process.[13] Under either approach, FERC will notice the post-solicitation demonstration, accept comments or protests from interested parties, and issue a ruling on the developer's capacity allocation process.

Non-Incumbent, Cost-Based, Participant-Funded Projects

FERC announced that it will apply the *Policy Statement* not only to new merchant transmission projects, but also to new non-incumbent, cost-based, participant-funded transmission projects.[14] FERC found that cost-based, participant-funded transmission projects are similar to merchant transmission projects in that both involve willing customers assuming part of a transmission project's cost in return for defined capacity rights (*i.e.*, there is no direct assignment of costs to captive customers).[15] However, FERC's approach to reviewing rates would continue to vary depending upon whether the project is a new merchant project or a new non-incumbent, cost-based, participant-funded transmission project. For a non-incumbent, cost-based, participant-funded transmission project, FERC will continue to review the transmission rates, terms and conditions, including any agreed upon return on equity, more closely to ensure that they satisfy FERC's precedent regarding cost-based transmission service.[16] The *Policy Statement* in both cases, however, will apply only to new transmission projects, and FERC clarified that developers that have already been granted negotiated rate authority will need to seek FERC's approval to deviate from their current capacity allocation process.[17]

Incumbent, Cost-Based, Participant-Funded Projects

FERC also announced that it is not changing its case-by-case evaluation of requests for cost-based, participant-funded transmission projects by incumbent transmission providers. FERC made it clear that the *Policy Statement* does not affect incumbent transmission development for purposes of serving native load. FERC stated that incumbent transmission developers differ from non-incumbent transmission developers in that the former have a clearly defined set of existing obligations under their Open Access Transmission Tariff ("OATT") with regard to new transmission development, including participation in regional planning processes and the processing of transmission service requests. On the other hand, non-incumbent transmission developers do not yet own or operate transmission facilities in the region, and thus are not yet subject to an OATT in that region.[18] Finally, FERC clarified that a non-incumbent transmission developer does not become an incumbent transmission developer in a given region until such time as it energizes a transmission facility within that region.[19]

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[12] *Id.* at P 34.
[13] *Id.* at P 31.
[14] *Id.* at P 39.
[15] *Id.* at P 6.
[16] *Id.* at P 40.
[17] Id at P 43.
[18] *Id.* at P 41.
[19] *Id.* at P 41 n. 67.

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Conclusion

In the *Policy Statement*, FERC announced that if merchant transmission developers and non-incumbent, cost-based, participant-funded transmission developers meet certain conditions, FERC will allow such developers to allocate up to 100 percent of their transmission project's capacity (including to a single customer or to an affiliate) through bilateral negotiations rather than through a more formal "open season" process. The *Policy Statement* should provide transmission developers with increased flexibility to negotiate with potential customers mutually beneficial rates, terms and conditions that can facilitate the development of new transmission projects.

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