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Practice Group:
Energy

Anchors Aweigh: FERC Proposes a Streamlined Process for Allocating Capacity of New Transmission Projects

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The Federal Energy Regulatory Commission (“FERC”) has issued a policy statement seeking comments on a proposed policy to address the allocation of capacity for new merchant transmission projects and new nonincumbent, cost-based, participant-funded transmission projects.¹ Comments are due by September 24, 2012. FERC proposes to allow developers to allocate 100% of the transmission capacity of their projects through bilateral negotiation. FERC’s objective is to ensure continued transparency in the capacity allocation process and thereby prevent undue discrimination in the capacity allocation process while affording developers the flexibility to negotiate bilaterally for the full amount of transmission capacity. Developers would no longer be required to offer all customers the same terms and conditions in a rigid open season process. Rather, under the new proposed policy, developers would have flexibility during the capacity allocation process to negotiate important terms and conditions on a bilateral basis with individual anchor tenants, thereby providing developers with the ability to address their unique needs and those of their potential customers.

In the Policy Statement, FERC proposes to streamline its capacity allocation policies, which have evolved through numerous petitions for declaratory orders that merchant and nontraditional transmission developers have filed. Currently, FERC evaluates merchant transmission based on a four-factor analysis developed in *Chinook Power Transmission, LLC* (“*Chinook*”).² The four factors are: (1) the justness and reasonableness of rates; (2) the potential for undue discrimination; (3) the potential for undue preference, including affiliate preference; and (4) regional reliability and operational efficiency requirements.³ Under the *Chinook* analysis, FERC relies upon an open season for the initial allocation of transmission capacity and a post-open season report to ensure transparency and prevent undue discrimination. In *Chinook*, FERC, for the first time, also permitted developers to allocate some portion of capacity through anchor customer presubscriptions, while requiring that the remaining portion be allocated in a subsequent open season.⁴ Since *Chinook*, FERC has ruled on several similar proposals, including a request to allocate up to 75% of a transmission project’s capacity to anchor customers.⁵ FERC has also permitted participant funding of transmission projects by both incumbent and nonincumbent transmission developers; however, in the Policy Statement FERC notes a clear distinction between incumbent and nonincumbent developers and does not propose to extend permission to incumbent transmission owners to allocate transmission capacity on a purely bilateral basis.⁶

In the Policy Statement, FERC states that bilateral negotiation is an “appropriate vehicle” for new merchant transmission projects and new nonincumbent, cost-based, participant-funded transmission projects. While FERC intends that *Order No. 1000*⁷ will ensure that transmission needs are identified and addressed through the regional transmission planning process, FERC also recognizes the importance of merchant transmission and cost-based participant-funded transmission projects and the critical role that bilateral negotiations play in providing flexibility for the development of those projects. Accordingly, the Policy Statement would serve as a “roadmap” for developers to pursue projects that, although not ultimately selected in a regional plan for purposes of cost allocation, have

Anchors Aweigh: FERC Proposes a Streamlined Process for Allocating Capacity of New Transmission Projects

sufficient value to warrant pursuing them through bilateral negotiations with potential customers.⁸ Pursuant to the Policy Statement, developers of such projects will be permitted to select a subset of customers, based on not unduly discriminatory or preferential criteria, and negotiate directly with them regarding key terms and conditions when the developers (1) broadly solicit interest in the project from potential customers and (2) submit a report to FERC describing the solicitation, selection, and negotiation process.⁹ If developers satisfy these two requirements, they may allocate up to 100% of their projects' capacity through bilateral negotiations.¹⁰ FERC also proposes to permit capacity to be allocated to affiliates; however, developers must still seek FERC approval if an affiliate is expected to participate as a customer on the project, and must show that the affiliate is not afforded an undue preference.¹¹

To satisfy the requirement of an open solicitation, FERC proposes to require developers to issue notice in a manner that ensures that all potentially interested customers are informed of the proposed project.¹² Such notice may be provided in trade magazines, regional energy publications, communications with regional transmission planning groups, and email communications to transmission-related distribution lists.¹³ The notice should include transmission developer points of contact and relevant projects dates, and provide technical specifications and contract information including: (1) project size/capacity, (2) end points of the line, (3) projected construction and/or in-service dates, (4) type of line (*i.e.*, DC, AC, bi-directional), (5) a precedent agreement (if developed), and (6) other capacity allocation arrangements.¹⁴ The notice would also specify the criteria for the selection of transmission customers.¹⁵

To prevent undue discrimination, FERC proposes to require developers to submit a report detailing the open solicitation process. The report envisioned must be submitted "shortly after" the open solicitation and resulting negotiations.¹⁶ The report must describe the processes that led to the identification of transmission customers and subsequent contract execution, the criteria used to select customers, any price terms, and any risk-sharing terms and conditions that served as the basis for identifying transmission customers that were selected as against those that were not.¹⁷ Developers of merchant transmission projects may file such reports either in conjunction with their requests for negotiated rate authority or as a compliance filing with respect to a FERC order approving such a request.¹⁸

Although FERC proposes to apply the proposed framework to both merchant transmission projects and nonincumbent, cost-based, participant-funded transmission projects, the Policy Statement retains the distinction between them.¹⁹ While the negotiations between developers and customers could in each case address transmission rates, FERC's approach to reviewing those rates for merchant and nonincumbent participant-funded transmission developers would remain different. Merchant transmission developers would continue to need to satisfy the four-factor analysis described in *Chinook* for negotiated rates; however, by following the Policy Statement, merchant transmission developers would be deemed to have satisfied the second (undue discrimination) and third (undue preference) factors of the *Chinook* analysis.²⁰ FERC will review proposed cost-based rates (including an agreed upon return on equity) for nonincumbent, cost-based, participant-funded transmission projects and will rely upon the criteria proposed in the Policy Statement only to address concerns regarding undue discrimination or preference regarding capacity allocation. Such projects will not be evaluated based on the other aspects of the *Chinook* analysis.²¹

Finally, FERC proposes not to apply the Policy Statement to evaluate requests for cost-based participant-funded projects submitted by incumbent transmission owners. Rather, FERC will continue to evaluate such proposals on a case-by-case basis. Unlike nonincumbent developers, incumbent transmission owners have a clearly defined set of obligations under their OATTs. FERC explains that

Anchors Aweigh: FERC Proposes a Streamlined Process for Allocating Capacity of New Transmission Projects

it would expect that in most cases incumbent transmission owners will be able to use existing processes set forth in their OATTs to allocate capacity on a new transmission facility.²²

Comments on the Policy Statement are due by September 24, 2012. Interested parties should consider commenting on the Policy Statement, which seeks to ensure that transmission developers have the flexibility necessary to continue to develop transmission projects outside of the regional planning processes that are being developed in accordance with *Order No. 1000*. Energy industry participants should follow the proceeding described in this Alert and should discuss any questions or concerns regarding this developing area with either of the authors or their regular K&L Gates contact.

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¹ *Allocation of Capacity on New Merchant Transmission Projects and New Cost-Based, Participant-Funded Transmission Projects, Priority Rights to New Participant-Funded Transmission*, Docket Nos. AD12-9-000 and AD11-11-000, 140 FERC ¶ 61,061 (2012) (“Policy Statement”).

² 126 FERC ¶ 61,134 (2009).

³ *Id.* at P 37.

⁴ Policy Statement at P 5.

⁵ *Id.*

⁶ *Id.* at P 6.

⁷ *Transmission Planning and Cost Allocation by Transmission Owning and Operating Public Utilities*, Order No. 1000, 136 FERC ¶ 61,051, 76 Fed. Reg. 49842 (Aug. 11, 2011), FERC Stats. & Regs. ¶ 31,323

Anchors Aweigh: FERC Proposes a Streamlined Process for Allocating Capacity of New Transmission Projects

(2011) (“*Order No. 1000*”), *order on reh’g and clarification*, Order No. 1000-A, 139 FERC ¶ 61,132, 77 Fed. Reg. 32184 (May 31, 2012), 139 FERC ¶ 61,132 (2012), *review docketed sub nom. S.C. Pub. Serv. Auth. v. FERC*, No. 12-1232 (D.C. Cir. filed May 25, 2012).

⁸ *Id.*

⁹ *Id.* at P 2.

¹⁰ *Id.* at P 12.

¹¹ *Id.* at P 23.

¹² *Id.* at P 15.

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.* at P 16.

¹⁶ *Id.* at P 20.

¹⁷ *Id.* at P 21.

¹⁸ *Id.* at P 22.

¹⁹ *Id.* at PP 24-25.

²⁰ *Id.* at P 12 n.29.

²¹ *Id.* at P 26.

²² *Id.* at P 27.