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FERC Revises Policies to Ease Financing of Merchant Transmission Projects

Continuing its support for solutions to increase the availability of renewable resources, the Federal Energy Regulatory Commission ("FERC") issued an order on February 19, 2009, to adopt a more flexible approach to analyzing requests for negotiated transmission rate authority for merchant transmission projects.[1] In a marked shift in policy, FERC's order allows a developer of two merchant transmission projects to pre-subscribe 50 percent of the capacity on each line to an "anchor customer." The anchor customer's agreement will serve as precedent for customers later selected through an open-season sale of the remaining capacity on each line. Prior to this order, FERC had required merchant transmission developers to sell all of a prospective transmission line's capacity through an open-season auction.[2] This hindered a new project's development because potential subscribers were unwilling to commit significant resources until a transmission developer could show that the project had commercial support – hence creating a "chicken and egg" problem. Use of an anchor customer for a significant amount of a prospective line's transmission capacity will enable developers to show demonstrable commercial support earlier in a project's development and encourage broader participation in the open season. FERC's adoption of the anchor customer model represents a significant step toward easing the financing challenges faced by merchant developers of high-voltage transmission lines.

> "The financial commitments made by anchor customers prior to an open season provide crucial early support and certainty to merchant transmission developers, which enables them to gain the critical mass necessary to develop these projects." Order at P 44.

FERC acted on two applications filed under Section 205 of the Federal Power Act, by affiliates Chinook Power Transmission, LLC ("Chinook"), and Zephyr Power Transmission, LLC ("Zephyr"), the developers of two proposed 1,000-mile, 500 kV direct-current transmission lines that will run from Montana and Wyoming to points south of Las Vegas, Nevada. The lines are expected to carry power from renewable wind resources to markets in the Southwest. Both Chinook's and Zephyr's proposals allocate 50 percent of the project's initial capacity to an unidentified anchor customer prior to the open-season process and commit to allocating the remaining 50 percent pursuant to an open season auction process.

[1] Order Authorizing Proposals and Granting Waivers, *Chinook Power Transmission, LLC*, Docket No. ER09-432-000; and *Zephyr Power Transmission, LLC*, Docket No. ER09-433-000, 126 FERC ¶ 61,134 (Feb. 19, 2009).

[2] FERC previously rejected proposals by merchant transmission owners to allocate a percentage of the capacity of projects before conducting an open season. *See, e.g., Neptune Regional Transmission System, LLC*, 103 FERC ¶ 61,213 at PP 17-18 (2003).

Unlike traditional transmission utilities, merchant transmission project owners assume all market risk because they have no set of captive customers from which to recover their investment costs. Until now, out of concerns for undue discrimination or preference, FERC has required project developers to auction 100 percent of merchant transmission capacity through an open-season process as a condition of approval of negotiated rate authority. Requiring the use of an open season for 100 percent of the line's capacity was "unduly rigid and inflexible," according to FERC. The new analysis gives merchant transmission owners the ability to contract a portion, or potentially even the entire capacity of the line, to an anchor customer.[3] The anchor customer is a generation company that contracts for the capacity on a line before the open-season process begins, and commits to sharing certain development costs for the project. The anchor customer model was supported by generator groups as a way to encourage new transmission investment in order to access remote renewable generation resources. FERC in the past approved the use of the anchor customer model for use by natural gas pipelines.

FERC's new analysis focuses on four areas of concern when considering approval of negotiated rate authority: (1) the justness and reasonableness of the proposed rates; (2) the potential for undue discrimination; (3) the potential for undue preference, including affiliate preference; and (4) regional reliability and operational efficiency requirements. FERC states that this refined analysis "allow[s] flexibility in addressing the financing realities and issues faced by merchant transmission owners" while preserving FERC's ability to determine whether granting the requested negotiated rate authority is just and reasonable.

Merchant transmission owners face financing difficulties because large transmission projects require very significant investments, and generators, purchasers and transmission owners are eager to learn whether others will commit resources to a particular project before making their own commitments. Allowing merchant transmission owners to solicit and obtain investments from anchor customers prior to an open season lets them obtain early financial support, which provides needed certainty and facilitates the acquisition of additional investments. According to FERC, the anchor customer model can help alleviate the "chicken and egg" problem that arises when generators, purchasers and transmission owners all wait for the others to commit money to a project before committing themselves. FERC believes that allowing merchant transmission owners to allocate portions, or all, of a project's capacity to an anchor customer may be a particularly effective method to address the challenges associated with location-constrained resources. FERC acknowledges that merchant transmission owners do not have an obligation to build these types of projects, and will therefore develop them only when and where a market for the projects exists.

FERC's acceptance of the anchor customer model is not without limitations. FERC will apply a higher level of scrutiny when the merchant transmission owner is affiliated with an anchor customer, participants in the open season and/or customers that take service on the transmission line. According to FERC, the absence of arm's length negotiations can raise concerns that unduly preferential treatment exists. One example of a situation that would draw greater scrutiny would be if a utility affiliate contract shifted costs to captive customers and provided an inappropriate subsidy of the project. FERC will evaluate such arrangements on a case-by-case basis and will require sufficient demonstration that the affiliate did not receive any undue preference. FERC emphasizes that, generally, affiliates should not participate in an open season, but where they do participate, a showing of no undue preference will also be required.

FERC also emphasized that merchant transmission owners of projects located in or adjacent to an RTO/ISO should consider transferring operational control to the RTO/ISO. Further, for those projects not located in or adjacent to an RTO/ISO, merchant transmission owners must file and provide nondiscriminatory service pursuant to FERC's *pro forma* OATT requirements. All transactions, whether affiliated or non-affiliated, must be conducted pursuant to the RTO/ISO OATT or, where the merchant transmission owner retains operational control, the merchant transmission owner's OATT. Finally, FERC declined to address the longstanding question of whether it would require merchant transmission line owners to expand their facilities upon request, as is required under the OATT for traditional utilities.

For more information concerning this Order as well as other FERC issues, please contact one of the Hunton & Williams attorneys listed in the "Contacts" section of this Client Alert.

[3] FERC states that it will evaluate any proposal to allocate "all or a portion" of the initial capacity of a transmission line outside of an open season on a case-by-case basis.