Client Alert

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New Rules for Electric Transmission Projects – The FERC "Three-Step": One Step Forward, One Step Back, One Leap Coming

Areas of Interest

Energy

United States

On February 19, 2009, the US Federal Energy Regulatory Commission (FERC) issued an order that is meant to encourage investment in the nation's electricity transmission infrastructure and assist companies in obtaining the necessary support from state regulatory authorities, generators and load-serving entities for the development of merchant transmission projects. In *Chinook Power Transmission, LLC and Zephyr Power Transmission, LLC*, 126 FERC ¶ 61,134 (Feb. 19, 2009) (Chinook/Zephyr Order), FERC approved requests by both Chinook and Zephyr to charge negotiated rates for their proposed merchant transmission projects and, following FERC's established practice with respect to interstate natural gas pipelines, approved Chinook's and Zephyr's proposals to presubscribe up to 50 percent of each project's 3,000 MW of capacity to anchor shippers.

This decision to permit presubscription to a portion of electric transmission capacity represents an important shift from FERC's traditional policy of requiring merchant transmission developers to allocate 100 percent of the initial capacity through pre-construction open seasons. Chinook/Zephyr Order, at P. 42. Noting its support of the continued development of merchant transmission projects, FERC found that allowing presubscription of capacity to anchor customers prior to an open season would "provide crucial early support and certainty to merchant transmission developers, which enables them to gain the critical mass necessary to develop these projects." *Id.* at P. 44, 46. However, FERC made clear that it would evaluate any proposal to allocate any portion of initial transmission capacity outside of an open season auction on a case-by-case basis to ensure that merchant transmission developers do not allocate initial capacity in an unduly discriminatory manner. *Id.* at P. 42.

FERC's decision in the Chinook/Zephyr Order builds on its existing natural gas pipeline precedents that have been very successful in obtaining anchor shipper support for new construction. FERC also took the opportunity to "refine and clarify" the 10 criteria it typically uses to evaluate merchant transmission owners' requests for negotiated rate authority for merchant transmission projects. FERC's refined analysis now focuses on four areas of primary concern, namely: "(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." Chinook/Zephyr Order, at P. 37. According to FERC, the new four-factor analysis reflects the policy concerns on which its previous ten-factor analysis was based, but it is less rigid and provides a more flexible method for analyzing negotiated rate requests that both serves FERC's consumer-protection goals and accommodates the financing realities faced by merchant transmission developers. *Id.* at P. 37, 54. When coupled with FERC's implementation of the Congressional directive to authorize incentive rates for certain transmission projects, transmission developers now have important new tools and incentives to use when pursuing new projects.

A day prior to FERC's release of the Chinook/Zephyr Order, another important development occurred regarding FERC's authority over the construction of electric transmission facilities. On February 18, 2009, the United States Court of Appeals for the Fourth Circuit issued its decision in *Piedmont Environmental Council v. Federal Energy Regulatory Commission*, 2009 U.S. App. LEXIS 2944 (4th Cir. Feb. 18, 2009), which limited the scope of FERC's authority under Section 216(b) of the Federal Power Act (FPA) (16 U.S.C. § 824p(b)), as added by the Energy Policy Act of 2005, to issue permits for the construction or modification of transmission facilities in national interest electric transmission corridors in instances where the applicable state permitting authority has failed to issue a timely decision approving or denying the requested permit.

Specifically at issue in *Piedmont* was FERC's issuance of a final rule interpreting the language in Section 216(b)(1)(C)(i) of the FPA to grant FERC the authority to issue permits for transmission siting when the applicable state permitting authority has "withheld approval for more than 1 year after the filing of an application" for a permit, even in those instances where the state authority has *affirmatively denied* the permit application within the one-year timeframe. Therefore, under its interpretation of the statute, FERC would be allowed to assume jurisdiction over transmission siting and override the state authority's denial of a permit. (FERC has not yet actually issued any project-specific authorizations under Section 216(b).)

The Fourth Circuit reversed FERC's interpretation of the statute, holding instead that Section 216(b) of the FPA, when read as a whole, clearly evidences Congress' intent to confer permitting jurisdiction on FERC "only when a state commission is unable to act on a permit application in a national interest corridor, fails to act in a timely manner, or acts inappropriately by granting a permit with project-killing conditions." 2009 U.S. App. LEXIS 2944 at *23.

The court decision is probably a short-term setback for several projects. However, the Senate and the House are both pursuing legislation that would provide FERC with the authority to issue construction permits for transmission lines devoted, at least in part, to renewable energy. Further details on the Senate bill will be available during the week of March 2. In addition, the recently enacted stimulus bill includes funding for a "smart grid" and a study of transmission grid adequacy. The combination of the recently enacted stimulus bill, the energy and climate change priorities set forth in President Obama's proposed budget, new statutory authority for FERC to site transmission lines, and FERC's new policies on anchor shippers and rate incentives for transmission projects could combine to make 2009 a breakthrough year for US transmission investment. FERC itself remains committed to incorporating renewables into the transmission system, as evidenced by its March 2, 2009, technical conference[1] on Integrating Renewable Resources into the Wholesale Electric Grid (AD09-4-000).

For more information on the Chinook/Zephyr Order, or any other topic raised in this Client Alert, please contact David I. Bloom (+1 202 263 3204) or Angela D. O'Brien (+1 312 701 8594), the authors of this alert.

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[1] See: http://www.ferc.gov/EventCalendar/EventDetails.aspx?ID=4490&CalType=%20&CalendarID=116&Date=03/02/2009&View=Listview.

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