Technical Conference on Priority Rights to New Participant-Funded Transmission
Docket Nos. AD11-11-000, *et al.*
Panel 2 - Generator Lead Lines

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- The Commission created the OATT to counteract monopoly power resulting from control of transmission systems. Order No. 888, which established the OATT, prohibits public utilities from using their monopoly power over transmission to engage in undue discrimination.

- In the Supreme Court's decision in *Otter Tail Power Company*, which originally articulated the basis for concerns regarding abuse of transmission monopoly power, the Court found that Otter Tail has "a strategic dominance in the transmission of power in most of its service area" and that it used this dominance to foreclose potential entrants into the retail area from obtaining electric power from outside sources of supply.

- It is useful to consider the gen-tie issue in light of the evil that the Commission sought to address in the relevant rulemaking proceeding and cases -- specifically, do gen-tie facilities convey transmission market power that results in strategic dominance?

- It is also helpful to view the issue so as to take into consideration (1) the significant economies of scale in transmission, and (2) environmental considerations associated with state and federal agency permitting of transmission lines.

- Others on the panel have provided descriptions of the burdens that open access and implementing an OATT impose on gen-tie owners, as well as the unfairness of a policy that can be characterized as "no good deed goes unpunished." In this case, companies that carry out the Commission's goal of building new transmission infrastructure risk having the rewards of their efforts made available to "free riders," who stood on the sidelines and let others carry the ball.

- However, based on my more than three decades of practice under the Federal Power Act, I would not bet that the Commission will waive the open access requirement for gen-tie facilities.

- Instead, my remarks assume that the Commission will continue to impose open access obligations on gen-ties. I will attempt to explain some of the problems caused by the Commission's current policy and will suggest some improvements that could continue to provide the benefits of open access while reducing the burdens imposed on gen-tie developers.

- The Commission's current policy can be characterized as "no good deed goes unpunished."

- At the heart of the Commission's policy is a prohibition on "banking" unused transmission capacity until the line owner, and no one else, wants to use it.

- As illustrated in the *Aesop's Fable* of the ant, who worked hard all summer to store food for the winter, and the lazy grasshopper, who chirped and played, we normally regard preparing for the future and storing unneeded goods until they are needed as a desirable quality, which policy-makers should encourage.

- When it comes to transmission, preparing for the future by banking capacity can provide more than a one-to-one benefit, since transfer carrying ability increases exponentially with increases in line voltage. In addition, the required right-of-way width decreases by more than a linear amount when higher voltage lines are used. State and federal permitting agencies, which are charged with examining the environmental effects of transmission line construction, are not likely to view favorably multiple, lower capacity lines where one higher voltage line could do the job.

- The current policy is likely to result in sub-optimal behavior by developers, which translates into additional costs and reduced incentives to pursue projects. The current test is whether the line owner can demonstrate that it has "specific, pre-existing generation plans" for the excess capacity on gen-tie lines it has developed.

- A project developer has a schedule pursuant to which it seeks to optimize the benefits of the project, which may involve phasing to reflect the market, equipment availability, permit requirements, feasibility testing, or an infinite variety of inputs to development. However, under the *Sagebrush* test, a developer is incentivized to expedite its plans and the associated costs, in order to establish an evidentiary record that it satisfies the "pre-existing plans" test.

- In addition, as we have seen in recent cases, in order to confirm that they have met the test, developers must pay the $24,140.00 fee to apply for a Commission declaratory order confirming their pre-emptive transmission rights. If the case is

contested, the costs can amount to hundreds of thousands of dollars in legal fees and hundreds of hours of company time documenting that their plans are sufficiently specific to pass the test.

- Under Section 219 of the Federal Power Act, the Commission's incentive package for transmission includes rates based on construction work in progress and recovery of 100% of the cost of any abandoned plan. In contrast, a gen-tie developer has no customers to charge for gen-tie costs that are under development and no captive customers to pay the costs of a failed project.

- If a gen-tie developer is successful in its efforts, but another project developer acquires priority transmission rights, its "buy-in" costs are based on traditional cost-of-service pricing, including utility-risk profile rates of return, which fail to reflect the risks that a developer bears in developing its gen-tie line.

- Is there a better way?

- To avoid or mitigate the "free rider" problem, the Commission could adopt a "speak now or hold your peace for one development cycle" approach. Under this approach, gen-tie developers could provide public notice of their intent to develop a gen-tie line and would hold an open-season. The developer would be entitled to reserve as much capacity as it desires for its own use but would offer to expand the line to satisfy open-season proposals, with a "good-faith" obligation to attempt to construct a line that would serve all who sign up -- similar to the obligation imposed in the OATT.

- However, a bidder that wants to obtain priority transmission rights must put "skin in the game," by making a substantial deposit, appropriately secured, and a commitment to provide funding as the project is developed. It would share the risk of non-completion, on the same basis as the developer. Those that choose not to make the financial commitment would waive their rights to seek priority access.

- In exchange for agreement to open up its transmission planning and development plans to third parties, the developer and those who signed up to participate would be exempted from the "no-banking" rule for one development cycle, *i.e.*, a Commission-established, technology specific period in which the developer would be exempted from the *Sagebrush* test.

- This approach would increase the likelihood that all parties (and their customers) will benefit from economies of scale, and would avoid the artificial incentives and litigation costs that developers now face. There is precedent for this approach in

pipeline certificate cases -- see discussion in Alfred Kahn's *The Economics of Regulation*, Volume 2, pp. 154-157.

- Finally, a developer that seeks to charge buy-in rates that accurately reflect its development risk often cannot afford the costs of a contested Commission rate case in which to establish risk-adjusted rates or a determination of what capital structure should be used to develop rates. The Commission should undertake a rulemaking that adopts a generic rate of return and capital structure, which establishes the default rate that a developer can charge for a buy-in of the transmission capacity that it has developed.

- Additional detail regarding these issues appears in "FERC Gen-Tie Policy Poses Risks to Renewable Project Developers," which is published in the March 2011 Chadbourne & Parke Project Finance NewsWire at p. 19. See the following link: http://www.chadbourne.com/files/Publication/d45a95ba-599c-4289-a72a-ef1c95800985/Presentation/PublicationAttachment/a85938c2-1c1c-4145-83ef-fa5e7b4c031f/PF_NewsWire_Mar11.pdf

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