UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, and Nora Mead Brownell.

Neptune Regional Transmission System, LLC — Docket No. ER01-2099-002

ORDER GRANTING, IN PART, AND DENYING, IN PART, REQUEST FOR MODIFICATION OF PRIOR ORDER AND GRANTING CLARIFICATION

(Issued May 21, 2003)

1. On July 27, 2001, the Commission issued an order approving Neptune Regional Transmission System, LLC's (Neptune) proposal to construct merchant transmission facilities.[1] On August 14, 2002, Neptune filed a "Motion to Modify Prior Order" (Motion), requesting that the Commission modify the July 27 Order to: (1) permit Neptune to negotiate with prospective customers to sell long-term transmission scheduling rights (TSR) without conducting another open season; (2) permit equity investors in Neptune and other Neptune affiliates to purchase TSRs directly from Neptune instead of relying on the secondary market; and (3) clarify TSR use-it-or-lose-it provisions. In this order, the Commission confirms its policy that TSRs should be sold initially in an open season and therefore denies Neptune's request to sell TSRs outside the open season. The order also grants Neptune’s request to sell TSRs to equity investors and affiliates, subject to condition. Finally, the order clarifies TSR use-it-or-lose-it provisions. This order benefits the customers by allowing for negotiated rates for merchant transmission projects, while ensuring that market power issues are adequately addressed.

**Background**

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[1] Neptune Regional Transmission System, LLC, 96 FERC ¶ 61,147 (2001) (Neptune-I), order on reh’g, 96 FERC ¶ 61,326 (2001) (Neptune-II), order on clarification, 98 FERC ¶ 61,140 (2002) (Neptune-III).

2. On May 23, 2001, Neptune, in Docket No. ER01-2099-000, proposed to construct a merchant transmission facility in four stages, with each stage adding 1,200 MW of new high-voltage direct-current underwater transmission cable. The project would connect the capacity-rich regions in Maine, New Brunswick and Nova Scotia with the capacity-constrained markets in Boston, New York City, Long Island and Connecticut. When originally proposed, the first phase of the project would consist of a 600 MW system that would connect a PSE&G substation near Linden, New Jersey to a ConEd substation at Farragut in Brooklyn, and two 300 MW cables which would connect a GPU substation at Red Bank, New Jersey to LIPA substations at Valley Stream and Bridge Road in Long Island.

3. In its original application, Neptune stated that the three subsequent stages of the project would be constructed to the extent they are supported by market demand. At the time, the second phase was proposed to connect New Brunswick to New York for the summer of 2004. The third phase was scheduled for 2005 and would connect Nova Scotia and Boston. The fourth phase, scheduled for 2006, was proposed to interconnect Maine and Connecticut.

4. After receiving Commission approval for its proposal, Neptune held an open season in September of 2001. Neptune notes that a number of potential bidders were concerned by the uncertainty relating to the fact that Neptune offered a new product that did not have any precedents as to either exactly what was being sold or what terms and conditions should govern the sale. These concerns were heightened by the fact that Neptune did not know what Regional Transmission Operator (RTO) or Independent System Operator (ISO) would be providing the transmission service, or what tariff would apply or what terms and conditions of service would be imposed on the transmission service.

5. Neptune contends that there have been significant changes in the market since it first filed its proposal. Neptune explains that the events of September 11, 2001 and the collapse of Enron significantly weakened a number of potential participants, particularly independent power companies that represented a prime source of both customers and investors. Further, Neptune notes, financial institutions are more cautious about investing in the deregulated energy sector, particularly with respect to novel merchant projects. As a result, Neptune states that there is no possibility that Phase One would be placed in service in 2003.

**Notices and Responsive Pleadings**

6. Notice of the filing was published in the Federal Register,[2] with comments, protests, and interventions due on or before September 5, 2002. On August 29, 2002, TransCanada Energy Ltd. (TransCanada) filed a timely motion to intervene. On September 5, 2002, the State of New York Department of Public Service (PSCNY) filed a notice of intervention and general comments in support of Neptune's motion. Also on September 5, 2002, TransÉnergie U.S. Ltd. (TransÉnergie), already a party to the proceeding, filed comments supporting in part and opposing, in part, Neptune's motion. In response, on September 20, 2002, Neptune filed an answer to TransÉnergie's comments.

## Discussion

### A. Procedural Matters

7. Pursuant to Rule 214(c) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214(c) (2002), the timely, unopposed motions to intervene make the entities that filed them parties to this proceeding.

8. While Rule 213(a)(2) of the Commission's Rules of Practice and Procedure[3] generally prohibits answers to protests unless otherwise permitted by the decisional authority, we will permit Neptune's answer because it provides additional information that assists us in the decision-making process.

### B. Open Seasons & Transmission Scheduling Rights

#### 1. Original Proposal

9. In its May 23, 2001 application, Neptune proposed to negotiate bilateral transactions with large customers prior to conducting the open season for up to 30 percent of the capacity of the system. Neptune stated that negotiating such transactions prior to the open season would provide it with assurances that there is adequate interest in the project, thus providing legitimacy and momentum. Neptune contended that as a practical matter, the rates negotiated through bilateral transactions would be capped by the same market forces that will cap rates during the open season.

10. The Commission did not approve Neptune's proposal with respect to bilateral negotiations. The Commission stated that if the project is economically viable, Neptune should be able to get binding financial commitments through contracts executed under the open season. The Commission further stated that since prices would effectively be capped

[2] 67 FR 55399 (2002).

[3] 18 C.F.R. § 385.213(a)(2) (2002).

at the same rates prior to and during the open season, there would be no financial benefit to Neptune by negotiating for 30 percent of its capacity prior to the open season. Finally, as a matter of policy, the Commission stated that all capacity for merchant transmission projects should be made available solely through the open-season process. The Commission explained that this policy will help ensure the Commission and all parties that the allocation of capacity is transparent, non-discriminatory and fair.[4]

### 2. Neptune's Motion

11. Neptune argues that the "transparent, non-discriminatory and fair" objective can be met without having an open season. Neptune states that market forces will ensure that no TSR purchaser pays more than its opportunity costs, regardless of whether the TSRs are purchased through negotiated transactions or an open season.[5] Neptune contends that this policy is particularly appropriate when the merchant transmission project has "no captive customers and assumes full financial risk for the project."[6]

12. In addition, Neptune contends that in the initial stages of TSR allocation, transparency is neither required to ensure non-discriminatory treatment nor specifically desired by the market participants seeking to purchase TSRs. Neptune claims that it has no incentive to treat market participants unfairly during its negotiations. Indeed, negotiations are intended primarily for the purpose of enabling parties to come to agreement on non-price related terms and conditions in a period of uncertainty prior to the financing of the project and the adoption of the final RTO. Neptune avers that it has no incentive to sell TSRs at prices lower than those resulting from the open seasons. Rather, it will seek to optimize the price and terms of any contract to sell TSRs, thereby maximizing the return on its investment. Neptune claims that each customer purchasing TSRs – whether in a negotiated deal or an open season – should pay no more than its opportunity costs.

13. Neptune further claims that the Commission's restriction on negotiated transactions has inhibited its ability to achieve contract terms that will permit it to move forward with the project. Neptune further believes that the policy is also inhibiting the development of

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[4] Neptune-I, 96 FERC at 61,634.

[5] Citing TransÉnergie, Ltd., 91 FERC ¶ 61,230 at 61,838 (2000) (TransÉnergie). ("The Commission has long permitted transmission-owning public utilities to charge the higher of embedded cost pricing or opportunity cost pricing for service on their transmission facilities.")

[6] Id. at 61,839.

other beneficial new transmission projects in a congested part of the country. Therefore, Neptune is asking the Commission to amend that policy.

14. Finally, Neptune states that it is extremely difficult to evaluate bids in a transparent open-season process based solely on net present value or other objective criteria. It further states that considerable subjective judgment is required to select among competing proposals. Neptune explains that the open-season process for the sale of long-term TSRs differs significantly from the open-season process for parties acquiring long-term transportation rights on natural gas pipelines. Transportation service is clearly described in the pipeline's tariff, and since the terms of service are "locked in," all that is left to negotiate is the price. Thus, bidders in pipeline open seasons compete against each other only with respect to the price they are willing to pay – subject to the applicable cost-based cap. The bidders in Neptune's open season, however, addressed subjects such as environmental and construction risk; price re-openers if the ISO/RTO tariff did not contain certain provisions; and the allocation of potential benefits from the construction of the Neptune project. Neptune contends that parties who are interested in participating in the project are not willing to do so because the terms and conditions of service are not clearly spelled out; the sponsors of the merchant transmission projects, however, cannot spell out the terms because the Commission has required that service be provided under the open-access tariff of an ISO/RTO.

### 3. Comments in Support of Neptune's Motion

15. TransÉnergie supports Neptune's proposal, provided that affiliates are barred from the initial allocation of transmission rights. TransÉnergie notes that the industry has gained substantial experience with open seasons in the merchant transmission context. TransÉnergie further contends that the burdens of the open-season process prescribed by the Commission have proved substantial. TransÉnergie notes that merchant transmitters, unlike gas pipelines, cannot pre-sell capacity prior to holding an open season. This limits the merchant’s ability to allay risk, with a concomitant dampening effect on project undertakings. Further, TransÉnergie notes that merchant transmitters have cumbersome and potentially competition-inhibiting reporting requirements.

16. In addition, TransÉnergie explains that the rationale to sell transmission capacity to bidders outside the open-season process as part of its initial project development is to reduce the up-front risk for the developer. TransÉnergie notes that on rare occasions, the Commission has allowed the allocation of capacity rights for offshore gas pipelines, such

as on the Outer Continental Shelf and in deep waters.[7] In sum, to allow the free market to function more effectively, TransÉnergie requests that the Commission eliminate the open-season process for all merchant transmission projects, except those involving affiliates.

### 4. Commission Conclusion

17. In this proceeding, Neptune contends that transparency is not required to ensure non-discriminatory treatment. It claims that it has no incentive to treat market participants unfairly during negotiations and therefore it should be permitted to sell TSRs outside of the open-season process for the initial allocation of TSRs. The Commission is not ready to abandon its policy that all initial transmission rights must be sold through an open season. Transparency is an essential element in helping the Commission and other parties ensure that all parties are treated fairly. The procedures established for the open-season process are the rules by which the Commission and other parties can judge whether the initial allocation of TSRs is non-discriminatory and fair. This transparency is important because, as discussed below, the Commission is allowing Neptune's affiliates to participate in the open season. Without the open season and the reports on the open season, it would be difficult, if not impossible, to verify that no undue preference was provided one party over another.

18. Although the Commission is not prepared to abandon its policy on open seasons, it is willing to consider other options to assist merchant transmission providers in exploring innovative methods for adding transmission to the power grid and for securing the financing needed for such projects. For example, in an order being issued contemporaneously with this order, the Commission is approving Conjunction LLC's (Conjunction) proposal for a four-part open season.[8] Part of Conjunction's rationale for the four-part open season is to avoid the types of problems experienced by Neptune and TransÉnergie in their open seasons. Also, the Commission notes that Neptune's criteria for evaluating bids, which is based solely on net present value, is more stringent than the criteria for evaluating bids by other merchant transmission projects. While Neptune's criteria is straight-forward, other proposals have set forth methodologies which take into account qualitative factors, such as

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[7] See, e.g., Green Canyon Pipeline Company, 47 FERC ¶ 61,310 (1989); Guardian Pipeline, L.L.C., 91 FERC ¶ 61,285 (2000), order on reh'g and issuing certificate, 94 FERC ¶ 61,269 (2001), order denying stay, 96 FERC ¶ 61,204 (2001).

[8] Conjunction LLC, 103 FERC ¶ 61,198 (Docket No. ER03-452-000) (Conjunction).

risk sharing.[9] The Commission is willing to consider proposals to modify Neptune's evaluation criteria. In addition, the Commission is willing to consider the development of standard TSR contracts. Finally, the Commission is willing to reconsider the issue of open seasons for the initial allocation of TSRs for projects in which equity investors and other affiliates do not participate.

### C. The Purchase of TSRs by Affiliates

#### 1. Neptune's Motion

19. Neptune's initial application proposed to allow affiliates to participate only in the secondary market for TSRs, barring participation in the open season used to allocate capacity on the Neptune Project. Neptune now requests that the Commission permit affiliate participation in the initial allocation or sale of TSRs as well as in the secondary market for TSRs. It submits that the restriction on affiliate participation has limited the number of potential equity investors and TSR bidders. Neptune argues that affiliate or investor acquisition of TSRs should not matter so long as the acquisition does not confer market power. Neptune states that it has no captive customers and thus there is no potential for affiliate abuse if affiliates are allowed to participate in the TSR market. Neptune cites the Commission's policy for affiliate transactions at market-based rates (whereby parties are permitted to transact with affiliates provided that the affiliate is not a franchised utility, and may transact with affiliates that are franchised utilities if a separate filing is made under Section 205 of the FPA). Neptune requests that the Commission adopt a similar policy for the sale of TSRs, i.e., allow Neptune to sell TSRs to any affiliate without a franchised service territory and to sell to franchised affiliates upon the approval by the Commission of a separate Section 205 filing.

#### 2. Comments

20. TransÉnergie opposes Neptune's request to permit its equity investors and other Neptune affiliates to purchase TSRs directly from Neptune instead of relying on the secondary market. TransÉnergie states that Neptune's Motion does not address how it would avoid affiliate abuse in its allocation of TSRs. In addition, TransÉnergie contends that potential investors could have captive customers, whose ratepayers could end up subsidizing TSR bids. TransÉnergie also notes that Neptune's Motion does not explain what protections it would put in place to prevent undue discrimination. TransÉnergie avers that the lack of market power does not mean that Neptune lacks the ability to discriminate in

[9] See, e.g., Northeast Utilities Service Co., 98 FERC ¶ 61,310 at 92,329 (2002) (NUSCO-II) and Conjunction.

favor of affiliates. Finally, TransÉnergie requests that if Neptune is allowed to sell to its affiliates it be required to: (1) demonstrate that its proposal does not present affiliate abuse concerns; and (2) conduct an open season and file the results with the Commission.

### 3. Commission Conclusion

21. Subsequent to its initial approval of the Neptune project, the Commission approved proposals for other merchant transmission projects to sell TSRs to affiliates. In approving TransÉnergie's Harbor Cable projects, the Commission concluded that allowing affiliates to participate in the open-season process did not present affiliate abuse concerns because the affiliates did not have captive customers in the United States.[10] The Commission also approved the sale of TSRs for NUSCO, whose affiliate, CL&P, has a franchise area.[11] In both of these cases, however, the applicants proposed to employ an independent consultant to evaluate the results of the open-access process. To be consistent with prior rulings, the Commission approves Neptune's request to sell TSRs to affiliates during the initial open season, conditioned upon Neptune hiring an independent consultant to evaluate the results of the open season and Neptune filing the independent consultant's evaluation as part of its report on the results of the open season.

22. Neptune agreed in its September 20, 2002 answer not to sell TSRs to affiliates with captive customers. Although this modification to Neptune's proposal is a good safeguard to help prevent affiliate abuse, the Commission will require a different type of safeguard. In NUSCO-II, to ensure that the merchant transmission affiliate would assume all financial risk for the project, the Commission required that separate books and records be maintained in accordance with the Commission's Regulations, and be made available for inspection.[12] To be consistent with the ruling in NUSCO-II, the Commission will require Neptune to keep separate books for itself and affiliated entities. The books should comply with Part 101 of the Commission's Regulations under the Uniform System of Accounts, and be subject to examination under Part 41 of the Commission's Regulations.[13] In

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[10] TransÉnergie Harbor Cable, 98 FERC ¶ 61,310 at 61,457 (2002).

[11] NUSCO-II.

[12] NUSCO-II, slip op. at 4.

[13] 18 C.F.R. Parts 101 and 41 (2001).

addition, the Commission will require Neptune to file financial statements and reports in accordance with Part 141 of the Commission's Regulations.[14]

23. Neptune proposed to file a separate Section 205 application to sell TSRs to franchised affiliates. The condition requiring Neptune to hire an independent consultant supplants the need for separate Section 205 filings.

### D. TSR Use-it-or-lose-it Provisions & Recall Rights

24. Neptune requests clarification regarding the "use-it-or-lose-it" feature of TSRs. In its initial application, Neptune proposed that TSRs not scheduled for use would be forfeited and sold in hourly open seasons, subject to recall by the original TSR holder. Neptune states that this feature was designed to prevent withholding, similar to the operation of Fixed Transmission Rights in PJM and Transmission Congestion Contracts in the New York ISO.

25. Neptune states that potential TSR holders thought that the right to recall their TSRs should be equivalent to the right that holders of firm transmission reservations have under the Order No. 888 pro forma tariff. Bidders were concerned that as the industry moves near real-time markets, the use-it-or-lose-it feature could cause TSR holders to lose their ability to participate in real-time or near real-time transactions because the TSR holders would lose their TSRs before real-time transactions could be consummated. Bidders therefore wanted to be able to recall TSRs lost in the use-it-or-lose process to the same extent that firm transmission rights holders could wait until immediately before real-time to schedule their firm transmission rights. Neptune therefore requests clarification that the deadline for recalling TSRs lost in the use-it-or-lose process be identical to the deadline under the SMD Tariff for changing transmission schedules. Neptune's request for clarification is granted. The deadline for recalling TSRs should be identical to the deadline for changing transmission schedules.

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[14] 18 C.F.R. Part 141 (2001).

The Commission orders:

(A) Neptune's request to sell TSRs in its initial allocation of TSRs without conducting an open season is denied.

(B) Neptune's request to permit equity investors and other affiliates to purchase TSRs directly from Neptune in the initial allocation of TSRs is granted, subject to conditions, as discussed more fully in the body of this order.

(C) Neptune's request for clarification that the deadline for recalling TSRs should be identical to the deadline for changing transmission schedules is granted.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.