November 19, 2012

FERC Reframes Nexus Test for Transmission Incentives Applications

Rate incentives may become more difficult to obtain; applicants are provided guidance on showings they are expected to make.

On November 15, the Federal Energy Regulatory Commission (FERC) issued a Policy Statement providing guidance on its evaluation of requests for rate incentives associated with electric transmission service.[1] FERC reframed the nexus test of its earlier Order No. 679[2] to focus more directly on the requirements of that order and emphasized its expectation that applicants take all reasonable steps to mitigate the risks of a project before seeking incentive returns on equity (ROEs). As a result of the Policy Statement, FERC will apply a more rigorous analysis to determine whether incentives are appropriate, and it may become more difficult to obtain rate incentives, particularly an increased ROE.

In Order No. 679, FERC established several rate incentives for investments in electric transmission infrastructure. FERC grants incentives for transmission projects if an applicant can show that (a) the project either ensures reliability or reduces the cost of delivered power through reduced congestion and (b) there is a nexus between the incentive sought and the investment being made. In applying the nexus test, FERC stated that it would consider whether the total package of incentives is rationally tailored to the risks and challenges of constructing new transmission. FERC subsequently concluded that it would evaluate whether a transmission project is "routine" or "non-routine" and that, once an applicant demonstrated that a project is not routine, it would be deemed to have satisfied the nexus test.[3]

In the Policy Statement, FERC replaced the routine/non-routine analysis with an analysis of the need for each individual incentive and the total package of incentives to determine whether an applicant satisfies the nexus test. Also, FERC reaffirmed that certain risk-reducing incentives may mitigate risk not accounted for in a transmission owner's base ROE. FERC emphasized that it expects applicants to first examine the use of non-ROE risk-reducing incentives before seeking an incentive ROE based on the project's risks and challenges.

FERC declined to specifically identify project characteristics or risks and challenges that would merit an incentive ROE but provided the following showings it expects an incentive applicant to demonstrate in the application:

- The proposed project faces risks and challenges not accounted for in the base ROE or addressed through risk-reducing incentives.
- The applicant is taking appropriate steps and using appropriate mechanisms to minimize its risks during project development.
- Alternatives to the project have been or will be considered in a relevant transmission planning process or a similar forum.

---

1. Promoting Transmission Investment Through Pricing Reform, 141 FERC ¶ 61,129 (2012), *available at* http://elibrary.ferc.gov/idmws/common/OpenNat.asp?fileID=13111026 [hereinafter Policy Statement].

2. Promoting Transmission Investment Through Pricing Reform, 116 FERC ¶ 61,057, *order on reh'g*, 117 FERC ¶ 61,345 (2006).

3. *Baltimore Gas & Elec. Co.*, 120 FERC ¶ 61,084, at PP 52–54 (2007).

FERC also stated that an applicant should limit the application of the incentive ROE based on the project's risks and challenges.

Finally, FERC identified the following three categories of projects that are likely to face the risks and challenges that could justify an incentive ROE:

- Projects that relieve chronic or severe grid congestion that has had demonstrated cost effects on consumers
- Projects that provide access to location-constrained generation resources for those that previously had limited or no access to the wholesale electricity markets
- Projects that apply new technologies to allow more efficient and reliable usage and operation of existing or new facilities

Contacts

If you have any questions or would like more information on the issues discussed in this LawFlash, please contact any of the following Morgan Lewis attorneys:

Washington, D.C.

John D. McGrane	202.739.5621	jmcgrane@morganlewis.com
Glen S. Bernstein	202.739.5994	gbernstein@morganlewis.com
Pamela C. Tsang	202.739.5199	ptsang@morganlewis.com

About Morgan, Lewis & Bockius LLP

With 24 offices across the United States, Europe, and Asia, Morgan Lewis provides comprehensive litigation, corporate, transactional, regulatory, intellectual property, and labor and employment legal services to clients of all sizes—from globally established industry leaders to just-conceived start-ups. Our international team of lawyers, patent agents, benefits advisers, regulatory scientists, and other specialists—more than 1,600 legal professionals total—serves clients from locations in Almaty, Beijing, Boston, Brussels, Chicago, Dallas, Frankfurt, Harrisburg, Houston, Irvine, London, Los Angeles, Miami, Moscow, New York, Palo Alto, Paris, Philadelphia, Pittsburgh, Princeton, San Francisco, Tokyo, Washington, D.C., and Wilmington. For more information about Morgan Lewis or its practices, please visit us online at www.morganlewis.com.