

Summary of and Clarifications Issued on FERC Policy on Long-Term Firm Transmission Rights

To comply with certain mandates of the Energy Policy Act of 2005, FERC on 7/20/06 issued Order No. 681 — a final rule (RM06-8; AD05-7) requiring regional grid operators with organized markets to offer long-term firm transmission rights to their market participants.

Order No. 681 specifies that long-term firm transmission rights must be made available for terms of ten years or longer. “In adopting this final rule, the Commission seeks to provide increased certainty regarding the congestion cost risks of long-term transmission service in organized electricity markets that will help load-serving entities and other market participants make new investments and other long-term power supply arrangements,” FERC explained. “The guidelines we adopt . . . are designed and intended primarily to ensure that the long-term firm transmission rights that are made available by transmission organizations that are subject to the rule have characteristics that support a long-term power supply arrangement.”

In May 2005, FERC staff had released a “white paper” discussing the potential creation of long-term firm transmission rights in regional markets that feature LMP, and asked interested parties to comment on the idea. Comments on that white paper showed that most market participants did not favor FERC’s taking a one-size-fits-all approach to the final rule. Taking the industry’s preferences into account, FERC decided not to offer strict rules and regulation regarding how long-term firm transmission rights are to be developed and allocated, but instead set forth guidelines that regional market operators were to use in developing their own firm transmission right strategies.

The guidelines, FERC has explained, allow for regional flexibility in the approach grid operators take regarding the allocation of long-term firm transmission rights.

In general, the seven guidelines specify the following:

- (1) Each long-term firm transmission right should specify a source and sink, and a quantity.
- (2) The long-term firm transmission right must provide a hedge against day-head LMP congestion charges or other direct assignment of congestion costs for the period covered and quantity specified. Once allocated, the financial coverage provided by a financial long-term right should not be modified during its term (the “full funding” requirement) except in the case of extraordinary circumstances or through voluntary agreement of both the holder of the right and the transmission organization.
- (3) Long-term firm transmission rights made feasible by transmission upgrades or expansions must be made available upon request to any party that pays for such upgrades or expansions in accordance with the transmission organization’s prevailing cost allocation methods for upgrades or expansions.
- (4) Long-term firm transmission rights must be made available with term lengths (and/or rights to renewal) that are sufficient to meet the needs of load-serving entities to hedge long-term power supply arrangements made or planned to satisfy a service obligation. The length of term of renewals may be different from the original term. Transmission

organizations may propose rules specifying the length of terms and use of renewal rights to provide long-term coverage, but must be able to offer firm coverage for at least a 10 year period.

(5) Load-serving entities must have priority over non-load-serving entities in the allocation of long-term firm transmission rights that are supported by existing transmission capacity. The transmission organization may propose reasonable limits on the amount of existing transmission capacity used to support long-term firm transmission rights.

(6) A long-term transmission right held by a load-serving entity to support a service obligation should be re-assignable to another entity that acquires that service obligation.

(7) The initial allocation of the long-term firm transmission rights shall not require recipients to participate in an auction.

The final rule gave grid operators 180 days to either propose specific long-term firm transmission rights designs that are consistent with the seven guidelines contained in Order No. 681, or explain how their existing practices are consistent with the guidelines.

The guidelines provide a framework within which transmission organizations and their market participants can design and implement long-term firm transmission rights in the organized electricity markets that are compatible with the design of those markets, in particular retaining the advantages of price-based congestion management, and meet the reasonable needs of market participants.

The Commission did not require transmission organizations to make major changes in their allocations or allocation procedures: “Most transmission organizations will be able to use their current allocation/auction system to allow load-serving entities to nominate source-to-sink transmission rights on a longer-term basis than is currently available,” FERC explained. “Transmission organizations will then assess those requests for feasibility and award a feasible set of transmission rights, as they do today.”

The final rule also allows transmission organizations to place reasonable limits on the total amount of capacity they will offer as long-term firm transmission rights. Consequently, load serving entities are not necessarily guaranteed that they will be able to obtain all the longterm firm transmission rights they request, or even sufficient long-term firm transmission rights to hedge their entire resource portfolios.

The final rule also required that each transmission organization with an organized electricity market implement a transmission system planning process that takes into account the need to accommodate allocated or awarded long-term firm transmission rights throughout their terms.

Although FERC was careful to note that it was not suggesting that this requirement imposes any “obligation to build” that does not already exist under the Commission’s Order No. 888, it nevertheless explained that it believes “that the transmission organization must plan its system to ensure that allocated or awarded long-term firm transmission rights are feasible.”

However, the Commission said the transmission provider must not only plan its system so that a long-term firm transmission right, once awarded, remains viable throughout its full term; it also must ensure that the right holder will not have to pay directly for any additional transmission upgrades that may be required to maintain the feasibility of the right over its term — pursuant to the “full funding” provision of the second guideline.

FERC clarified that it “will not require that long-term firm transmission rights in organized electricity markets be physical or financial rights,” but it also “will not require that transmission organizations with existing or approved designs for financial transmission rights create a new long-term physical right . . . upon request of a load serving entity.” Instead, the order said, the Commission “sought to provide guarantees of financial ‘firmness’ alongside the existing physical firmness of transmission scheduling in the organized electricity markets.”

Finally, the instant order defined an organized electricity market to specify that, in the context of the final rule, the term “means an auction-based *day-ahead and realtime wholesale* market.”

A 11/16/06 rehearing order largely upheld FERC’s Order No. 681, although it did offer several limited clarifications.

FERC refused to revisit the final rule’s adoption of just a general preference for LSEs in the allocation of LTTRs, reiterating that the provision will still allow LSEs to obtain LTTRs for long-term power supply arrangements to meet their service obligations. However, FERC agreed to clarify that when a regional grid operator does not have enough existing capacity available for long-term firm transmission rights to support the “reasonable needs” of all LSEs, the transmission organization should give priority to the LSEs having long-term power supply arrangements. The Commission promised that “if it becomes apparent that LSEs with long-term power supply arrangements are being crowded out” of the allocation of LTTRs, it would “take appropriate steps to address the issue.”

In another clarification in the November 2006 rehearing, FERC said that if an LSE has agreed to pay some of the embedded costs of the transmission system on a long-term basis to support load outside the region, the grid operator should grant that LSE a preference equal to that given to LSEs with loads within the transmission organization’s region.

Furthermore, FERC said the preference should apply even if pancaked rates between the transmission organization and the other transmission provider have been eliminated, as long as an agreement requires the LSE to share some of the costs “in accordance with the non-pancaked rates currently in effect.”

Order No. 681-A further clarified that in the absence of such an agreement, an LSE with load that sinks outside the grid operator’s region “is entitled to receive long-term firm transmission rights from existing system capacity to support that load to the extent that

capacity is available after the needs of the LSEs whose loads are within the region have been met.” However, FERC said the LSE should be required to contribute, on a long-term basis, toward the embedded cost of the transmission system by paying either the applicable pancaked or non-pancaked rates.

In another clarification, FERC decided that water pumping entities — such as California’s Dept. of Water Resources — should be treated as LSEs for the purposes of allocating LTTRs, even though such entities do not fit the strict definition of an LSE.

FERC added that each transmission organization should explain in a compliance filing how its proposal addresses potential seams issues between itself and neighboring non-transmission organization transmission providers, as well as between itself and neighboring transmission organizations.

Finally, among other things, Order No. 681-A agreed that all transmission organizations —including the California Independent System Operator — must provide a timetable for implementing LTTRs. The clarification was made in response to concerns expressed by several California entities that the Cal-ISO may not fulfill a FERC directive that it start to offer LTTRs at the same time it implements a new market design, set to take place in November 2007.

On March 20, 2009 FERC affirmed “the fundamental determinations” made in Order No. 681 and Order No. 681A Order requiring regional grid operators with organized markets to offer long-term firm transmission rights to their market participants.

However, the agency also clarified certain aspects of those earlier rulings. In particular, Order 681-B affirmed that a grid operator may, under certain circumstances, give priority to load serving entities located within its own control area when allocating long-term firm transmission rights. However, the commission added that external load serving entities that contribute to the embedded costs of the grid operator’s system on an ongoing basis may be entitled to the same priority the grid operator affords to internal load serving entities.

Of the seven guidelines the final rule established to help grid operators develop their own strategies regarding the allocation of long-term firm transmission rights, guideline 5, which outlined the priority that should be given to various entities when allocating long-term firm transmission rights, caused the most controversy.

Order No. 681 Guideline 5 provides that “load serving entities must have priority over non-load serving entities in the allocation of long-term firm transmission rights that are supported by existing capacity.” FERC explained in Order 681 that “any entity that has neither an obligation to serve load on the transmission organization’s transmission system, nor an obligation to pay the embedded costs of that system, should not be given a preference to acquire long-term firm transmission rights supported by the system’s existing capacity.”

In the November 2006 Order 681-A, FERC affirmed the general determinations of the underlying order but offered certain clarifications, including several related to the methodology used for allocating long-term firm transmission rights.

Of particular importance here, Order 681-A clarified that a load serving entity should be afforded a preference “only to the extent that the transmission organization plans and constructs its transmission system to support the load of the load serving entity, and the load serving entity contributes to the cost that the transmission organization incurs for that purpose.” FERC further explained that external load serving entities should be given a preference in the allocation of long-term firm transmission rights equivalent to that accorded internal load serving entities if they pay a share of the embedded costs of the transmission system on a long-term basis.

The Long Island Power Authority, as well as the Modesto Irrigation District and the Sacramento Municipal Utility District in California, sought rehearing of Order 681-A.

First addressing concerns raised by Modesto, FERC clarified that it “did not intend to restrict unnecessarily the types of contractual vehicles by which a load serving entity with load outside a transmission organization’s region may demonstrate that it is entitled to receive a preference in the allocation of long-term firm transmission rights.”

Modesto had argued that the guideline in question discriminated against external load serving entities that wheel power over an RTO- or ISO-controlled grid because those entities contribute to the embedded cost of the transmission system through the rates they pay to their transmission providers and not through direct payments to the grid operator. According to FERC, however, the salient issue is whether, and not how, an external load serving entity has contributed and will continue to contribute to the embedded costs on an ongoing basis. “Thus, a commitment to pay an appropriate share of embedded costs could be achieved through a contractual agreement with the transmission organization itself, through a pre-existing agreement with one or more transmission owners that have turned operational control of their transmission system over to the transmission organization, or by some other verifiable means,” the commission clarified.

In response to concerns raised by SMUD, FERC clarified that the lack of an existing long-term service agreement with the transmission organization or a participating transmission owner “does not necessarily disqualify” an external load serving entity from being eligible for the preference.

For instance, FERC said that such an entity may be entitled to the preference if it “has maintained a continuous service relationship with the transmission organization or transmission owner, through which it continues to contribute to the embedded costs of the transmission system for the duration of the long-term firm transmission rights it seeks.” However, the commission stressed that the entity also must “satisfy all of the other eligibility requirements of the transmission organization, and it must provide the transmission organization with appropriate assurances that it will continue to satisfy these requirements going forward.”

Turning to issues raised by LIPA, FERC clarified one specific paragraph of Order 681-A, which provides that an external load serving entity without an existing agreement to pay embedded system costs is entitled to receive long-term firm transmission rights to the extent that capacity is available after the needs of internal load serving entities are met. FERC explained that paragraph “is intended to apply only to situations where a load serving entity with load external to the region makes an initial request to obtain long-term firm transmission rights.”

The Commission also clarified that while a transmission organization may establish a variety of criteria for determining when a load serving entity is eligible to receive an allocation preference, it must make certain not to unduly discriminate between internal and external load serving entities when applying those criteria. For instance, if a transmission organization allocates long-term firm transmission rights using a system of stages or tiers, the Commission said it would expect “all qualified load serving entities to be placed in the same allocation stage or tier without regard to whether its load is internal or external to the region.”

Finally, the Commission said a transmission organization may impose reasonable additional requirements on customers external to the transmission organization’s control area as a precondition of receiving long-term firm transmission rights, as “it is within the transmission organization’s purview to create rules that aim to ensure equitable allocation/distribution of these potentially valuable rights.” On the other hand, the agency clarified that “any differences in the attributes ... of long-term firm transmission rights that are allocated among load serving entities should not be based on whether a load serving entity is internal or external to the transmission organization.”