
E International regulators' approach to merchant transmission investment

E.1 United States

Over the past decade, several merchant transmission projects have emerged in the United States, largely in response to two factors.

- The development of organised electricity markets (operated by regional transmission organisations and independent system operators). This created a need for additional transmission capacity to support generation competition, and provided opportunities for merchant transmission providers to offer competitive generation alternatives.
- State policies promoting renewable energy sources. Merchant transmission providers emerged, seeking to build transmission projects to bring renewable energy to customers. Sources of renewable energy were typically remote from customer centres, in locations with insufficient transmission capacity.

The US Federal Energy Regulatory Commission (FERC), which is responsible (among other things) for the regulation of wholesale sales of electricity and the inter-state transmission of electricity, has recognised the role merchant transmission projects play, particularly in expanding competitive generation alternatives. It distinguishes merchant transmission providers from other (incumbent) transmission providers by the fact that they 'do not serve captive retail customers and assume all market risk of a transmission project' (Werntz 2011, p. 424).

The FERC has developed a case-by-case approach, which it refined in 2009, to allow merchant providers to charge negotiated rates with their customers on a contractual basis. The approach involves the application of a four factor test to the merchant transmission project: justness and reasonableness of rates; potential for undue discrimination; potential for undue preference, including affiliate preference; and regional reliability and operational efficiency requirements. Among the requirements that the FERC imposes in relation to the four factors are the following.

- The merchant provider assumes full market risk and is not building within a region to ensure there are no 'captive customers' to subsidise the project.

-
- Merchant providers should offer all their capacity through transmission rights to all comers in ‘open season’ auctions.
 - Merchant providers are allowed to pre-subscribe a proportion of transmission capacity to ‘anchor customers’ before holding ‘open season’ auctions to allocate the remainder of their capacity.

The FERC’s approach seeks to balance the requirement of the Federal Power Act that negotiated rates are ‘just and reasonable’, core principles such as ‘open access’ to transmission and transparency in capacity allocation, and the need for merchant transmission providers to secure finance for their projects.

E.2 European Union

Until 2003, transmission investments were only permitted to be undertaken by regulated transmission and system operators.

Prompted by concerns about under-investment in cross-border electricity transmission, and the impacts this had on competition within the European market, the European Commission (EC) introduced the second energy package in 2003 and later the third energy package in 2009.

The second energy package of 2003 allowed merchant investors to obtain authorisations to undertake merchant transmission investment (in interconnectors) from national regulatory authorities (NRAs) and the EC. To be authorised, a merchant investor had to obtain exemptions from regulated third-party access and the use of the collected congestion rent — article 7 of regulation 1228/2003 on cross border exchange.

Exemptions could only be granted if the following conditions, contained in article 7(1), were met:

- (a) the merchant interconnector should enhance competition in electricity supply
- (b) the level of the risk is such that the investment would not take place unless the exemption is granted
- (c) the interconnector must be owned by a person legally separate from the transmission and system operators
- (d) charges must be levied on users of the interconnector

-
- (e) no part of the capital or operating costs of the interconnector has been recovered from any component of charges made for the use of transmission or distribution systems linked by the interconnector
 - (f) the exemption is not to the detriment of competition or the effective functioning of the internal electricity market or the efficient functioning of the regulated systems to which the interconnector is linked.

The exemptions mainly concerned DC interconnectors, but AC interconnectors may also be considered in exceptional circumstances.

The NRAs of the member states involved generally had jurisdiction over the granting of the exemption. The merchant investor thus had to submit applications to each NRA, which could impose additional conditions. The member states or the NRAs involved had to cooperate and find common grounds for the grant of the exemption. Where there was a sustained disagreement between them, the project could not proceed. If they agreed, the European Community retained the right to propose amendments or to completely withdraw the exemption.

The third energy package of 2009, with effect from March 2011, introduced a new regulation, which repealed the existing regulation on cross-border exchange. The new regulation 714/2009 retained the conditions in the previous article 7(1) for exemptions — now article 17(1) — but altered the allocation of decision making powers. NRAs remain in charge of the examination of applications but can jointly decide to delegate their power to the new Agency for the Cooperation of Energy Regulators (ACER). They are also required to notify the ACER and the European Community as soon as they receive a new exemption application and inform them of their common decision. The ACER is to take a final decision in case of a sustained disagreement between the NRAs involved.