LANDOWNER COMPENSATION IN TRANSMISSION SITING FOR RENEWABLE ENERGY FACILITIES

a report by Rosalie Winn and the Center for Rural Affairs
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EXECUTIVE SUMMARY

Economic and environmental concerns have combined to popularize the use of large-scale renewable energy projects as a source of electricity generation. The price of electricity generated by wind or solar power is more competitive today than ever before. State and federal standards designed to limit the amount of carbon pollution emitted by coal-fired power plants further increase the appeal of renewable resources.

Despite these realities, the development of renewable energy projects is continually limited by existing transmission capacity. Without increased transmission infrastructure the full benefits of wind and solar power cannot be realized.

Efforts to increase transmission capacity are routinely delayed by siting challenges, including the use of traditional eminent domain, that often pit private landowners against transmission developers. While eminent domain remains a useful tool, too heavy a reliance can be problematic. The resulting distributive impacts and economic inefficiencies compromise the intended goal of providing accurate and adequate landowner compensation. They often cause unnecessary expense and debilitating delays in projects.

It is not uncommon for these consequences to prevent project construction altogether. Average costs associated with acquiring land and assembling it into corridors can compose 10 percent of transmission development costs – up to $400,000 per pole mile.

This paper will consider current procedures used in the electric transmission siting context and will evaluate the potential application of a new method of landowner compensation, the Special Purpose Development Corporation (SPDC). The SPDC framework achieves the same development goal as traditional eminent domain while avoiding several significant concerns associated with a dependence on ‘fair market value’ as the sole basis for landowner compensation.

This is achieved in part by overcoming the collective action problems that plague traditional land assembly processes through aligning the interests of landowners with interests in development through market-based compensation and an emphasis on stakeholder participation.

As will be seen, the application of this tool gives rise to its own set of challenges. A unique set of questions regarding formation, ownership, governance, and transaction costs must be addressed. Resolving these issues, and others that may arise, represent the first steps necessary to arrive at an outcome satisfactory to both developer and landowner, and one that enables us to meet the growing demand for renewable energy both now and in the future.
INTRODUCTION

Part I of this paper discusses the growth in renewable energy and the resulting need for new transmission lines. Part II reviews current land assembly practices for siting new transmission and considers the justifications for eminent domain usage in land assembly. Part III introduces an alternative method of landowner compensation, the Special Purpose Development Corporation (SPDC), considers ways in which the SPDC model can overcome issues with traditional eminent domain, and analyzes the application of the SPDC model to transmission siting.

I. CONTEXT: GROWTH IN RENEWABLE ENERGY AND INCREASED NEED FOR TRANSMISSION

Domestic renewable energy production has expanded in recent years, and will need to continue to develop in order to limit carbon pollution and attain energy independence goals.1 Along with the overall increase in demand for new electricity generation driven by economic growth and retirement of coal-fired power plants, state Renewable Portfolio Standards and consumer preferences are spurring demand for electricity from renewable sources.2 More than half of the states have adopted renewable electricity standards, which require that providers of electricity receive a minimum percentage of power from renewable generators by a set date, and demand for renewable electricity generation now exceeds supply.3 Renewable energy, such as solar or wind power, cannot be transported like traditional fossil fuels, such as coal. Instead, renewables must be converted to electricity at their source. Sources of renewable energy, such as high-wind sites in rural areas, are often located far from load centers for demand, such as population-dense cities. To meet this increase in demand for renewable energy, additional transmission will be needed to link new renewable electricity generation projects to load centers.4 Lack of adequate transmission can act as a "bottleneck" for increased use of renewable electricity.5

3 Id.
4 Klass, supra note 1, at 1084.
5 Johnathan Hladik, Ctr. for Rural Affairs, Opportunity on Landowner Compensation in Transmission Siting | Center for Rural Affairs
II. CURRENT LAND ASSEMBLY PRACTICES IN TRANSMISSION SITING

Once attempts to reach a voluntary agreement have failed, transmission developers are authorized by the state public utilities commission to take needed land through the process of eminent domain. Part IIA provides an overview of regulatory jurisdiction for transmission siting. Part IIB reviews the existing transmission siting process conducted by state public utility commissions, which typically culminates in a grant of authority to the transmission developer to exercise eminent domain power. Part IIC examines the requirements, benefits, and defects of eminent domain.

A. REGULATORY JURISDICTION OVER TRANSMISSION SITING

The primary authority for permitting and siting new transmission lines is at the state level, although the Federal Energy Regulatory Commission (FERC) has limited siting authority. Most states have granted authority to review transmission line siting to their state Public Utilities Commission (PUC) through state siting statutes. Transmission lines may also be subject to some degree of local or municipal control.

B. EXISTING TRANSMISSION SITING PROCESS BY STATE PUBLIC UTILITY COMMISSIONS: REVIEW AND APPROVAL OF PROJECTS

Most states require a demonstration of need for new transmission and an environmental assessment before approving a transmission project proposal. State approval will generally culminate in a “Certificate of Need” or “Certificate of Public Convenience and Necessity,” which will typically enable the transmission developer to exercise the power of eminent domain to take land for transmission siting. The power to condemn property under eminent domain is restricted to public utilities in some states. States may require developers to attempt to negotiate in good faith before exercising eminent domain.

Some states make distinctions during the transmission siting approval process between traditional, integrated utilities, which provide electricity generation, transmission, and distribution, and private transmission-only developers. The Energy Policy Act of 2005 requires a utility to provide interconnection services for any customer in that utility’s service area. This created a market for private or “merchant” transmission lines to compete with the vertically integrated utilities that traditionally owned and operated transmission lines. While virtually all states grant eminent domain power for transmission development to traditional public utilities, some states expressly prohibit the grant of eminent domain authority to merchant transmission companies.

C. EMINENT DOMAIN

Eminent domain, or the authority to take private property for public use, is a traditional power of sovereign government. The power of eminent domain is limited by the Takings Clause in the Fifth Amendment, which requires that taken property be put to Public Use and that Just Compensation be provided for the taking. The purpose of eminent domain is to overcome defects with private land assembly, but the eminent domain process also presents serious issues.

The two Constitutional requirements for eminent domain takings are public use and just compensation. The development of transmission lines has traditionally been accepted as a public use, and the issuance of a state Certificate of Need for transmission siting requires a utility to provide interconnection services for any customer in that utility’s service area.

11 Klass, supra note 1, at 1101-03.
12 Klass, supra note 1, at 1102.
13 Klass, supra note 1, at 1109.
15 Klass, supra note 1, at 1121.
16 Id. at 1124-25. For a full discussion of state siting laws and their implications for merchant transmission companies, see id. at 1123-27, 1156-62.
17 Id. at 1103-04.
18 U.S. CONST. amend. V (stating private property cannot “be taken for public use, without just compensation”); see also Chicago Burlington and Quincy R.R. v. City of Chicago, 166 U.S. 226 (1897) (applying the Fifth Amendment to state actions through the Fourteenth Amendment).
generally fulfills the public use requirement. To satisfy the just compensation requirement, property owners are compensated at Fair Market Value (FMV) for their land. To determine FMV, a court will estimate “the value that a willing buyer would pay a willing seller for the particular parcel at its highest and best use on the open market.”

The fundamental purpose of eminent domain is to prevent issues that arise in private land assembly from halting socially beneficial projects. Private, voluntary land acquisition through transactions on the open market suffers from several defects when used for public projects: holdout problems, other collective action concerns, and negotiation costs. First, in private land acquisitions, landowners may “hold out” for the value of the economic surplus created by land assembly by refusing to sell their land. If there are several holdouts, beneficial projects will not go forward if the developer cannot afford to pay the surplus to each owner. Second, collective action issues will make it difficult for landowners to coordinate with each other, since each has an incentive to holdout. Third, developers will find it costly to negotiate with individual landowners, particularly if holdouts may ultimately scuttle the project, leaving the developer with sunk costs of already-purchased land. Eminent domain overcomes these issues by making the transaction to sell land involuntary.

While eminent domain is useful for helping socially beneficial projects overcome holdout and collective action issues, the eminent domain process has several serious defects. The use of FMV as “just compensation” has distributive impacts and suffers from economic inefficiencies.

Eminent domain has distributive consequences resulting from the use of FMV that impact the “fairness” of the process. First, FMV does not incorporate the subjective value of the land to its owners. Subjective value includes the social capital landowners receive from living in the area and unique modifications to the land. Since subjective value is not included in FMV calculations, landowners lose this value in an eminent domain taking. Second, developers, rather than landowners, capture the enhancement in the value of the land due to assembly. As an aggregated parcel that can be used for siting a transmission line, land is being put to its highest and best use—the sum is worth more than its parts. Landowners lose out on this land assembly surplus under FMV.

There are also economic inefficiencies associated with eminent domain. These inefficiencies arise because the use of eminent domain depends, at least in part, on the use of political capital to influence the likelihood of a taking. Both developers and landowners have incentives to maximize their own profits through rent-seeking behavior, which occurs when an actor seeks to redistribute existing wealth to itself through political or economic manipulation rather than create new wealth. Rent-seeking behavior can lead to inefficient outcomes when eminent domain is available for land assembly for a project. Developers with political capital (a disproportionate ability to influence the grant of eminent domain through regulatory influence or capture) have an incentive to seek the power of eminent domain to increase their profits. Even in situations where holdouts are unlikely, developers would prefer to acquire land through eminent domain because eminent domain requires only the payment of FMV to landowners, not subjective valuation or land assembly value. Alternatively, landowners with political capital have an incentive to oppose the use of eminent domain through delay or litigation to attempt to capture their subjective value.

28 Heller & Hills, supra note 20, at 1475.
29 Id.
30 See Kimball Laundry Co. v. United States, 338 U.S. 1, 5 (1949) (“[L]oss to the owner of non-transferable values deriving from his unique need for property or idiosyncratic attachment to it, like loss due to an exercise of the police power, is properly treated as part of the burden of common citizenship.”).
31 Heller & Hills, supra note 20, at 1475-76.
32 See United States v. Miller, 317 U.S. 369, 375 (1943) (“[S]pecial value to the condemnor as distinguished from others who may or may not possess the power to condemn, must be excluded as an element of market value”).
33 Merrill, supra note 23, at 85-89.
34 Id. at 85.
35 Heller & Hills, supra note 20, at 1482.
and the land assembly surplus.\textsuperscript{36} Landowner opposition can result in high project costs and the prevention of socially beneficial projects.\textsuperscript{37}

Although eminent domain serves an important function in overcoming holdout and collective action issues, the distributive impacts of FMV and economic inefficiencies from rent-seeking behavior in traditional eminent domain proceedings are problematic. In the transmission-siting context these issues can delay or prevent any transmission project, including those intended for renewable resource development.\textsuperscript{38} Costs associated with acquiring land and assembling it into transmission corridors can compose 10 percent of transmission development costs—up to $400,000 per mile of transmission lines, depending on voltage capacity.\textsuperscript{39}

\section*{III. AN ALTERNATIVE METHOD OF COMPENSATION FOR LAND ASSEMBLY: THE SPECIAL PURPOSE DEVELOPMENT CORPORATION}

The Special Purpose Development Corporation (SPDC) is an alternative framework for land assembly in situations where traditional eminent domain can be utilized. Developed by Amnon Lehavi and Amir Licht, the SPDC framework aims to restructure the just compensation regime for eminent domain takings to use market-based valuation mechanisms to incorporate the land assembly value into compensation.\textsuperscript{40} The SPDC framework seeks to overcome the collective action problems that plague traditional land assem-

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bly processes by aligning the interests of landowners with interests in development through market-based compensation. While the SPDC framework was originally proposed for economic development projects, the framework is applicable to transmission land assembly, although special considerations are needed in the transmission context.

Part IIIA will describe the organizational structure of a SPDC. Part IIIB will review the goal of the SPDC model: overcoming collective action problems in land assembly. Part IIIC will develop specific recommendations for applying the SPDC model to land assembly for transmission siting.

A. ORGANIZATIONAL STRUCTURE OF A SPECIAL PURPOSE DEVELOPMENT CORPORATION

The SPDC is a corporation formed by a public authority for the purpose of aggregating land. Once a parcel of land has been identified, the authority exercises its power of eminent domain to take the land necessary for the project. Landowners whose property is taken are given a choice for just compensation: traditional FMV or shares in the SPDC. Securities in the SPDC are allocated to the landowners who opt-in based on the assessed value of the land. Financing for the FMV payments to landowners who opt out of the SPDC is provided by the condemning authority; the authority then receives shares in the SPDC. Shares in the SPDC are tradable. According to financial market theory, the share price will reflect the “true economic value” of the net present value of the profits anticipated from the sale of the SPDC’s land. Once all land needed for a project has been acquired by the SPDC, the land is sold or auctioned to a developer. The proceeds from the sale are paid as dividends to the shareholders of the SPDC.

B. ROLE OF THE SPECIAL PURPOSE DEVELOPMENT CORPORATION IN OVERCOMING COLLECTIVE ACTION ISSUES

The SPDC framework achieves the same development goal as traditional eminent domain while avoiding several problematic issues associated with relying FMV as the sole option for justly compensating landowners. The SPDC framework has economic, distributive, and participation effects. The main economic benefit of eminent domain—overcoming holdout issues in land assembly—is achieved through the SPDC framework. Because the SPDC becomes the sole holder of the land necessary for a given project, there are not multiple landowners who may holdout for the assembly surplus. In addition, the SPDC helps to overcome the economic inefficiencies of traditional eminent domain. Rent-seeking behavior by both developers and landowners is reduced when the assembled land is clearly valued through a market pricing mechanism. The assembly value of the land is transparently reflected in the price of SPDC shares. The SPDC framework also alters the distributive effect of traditional eminent domain. With an SPDC, landowners rather than developers will capture the assembly value (either paid out in dividends or reflected in the price for which shareholders sell SPDC securities) from their land being pooled into an assembled corridor. This financial alignment of interests should decrease landowner opposition to projects. Finally, the SPDC will have participation effects. Landowner participation in and support for the development process is increased, as landowners are given a financial stake in the success of the project. Landowner participation is valuable in part because landowners can provide important insights regarding localized concerns.

C. TRANSMISSION-SPECIFIC CONSIDERATIONS FOR THE SPECIAL PURPOSE DEVELOPMENT CORPORATION

The application of the SPDC framework to transmission siting raises unique issues. This paper will address four possible challenges to using a SPDC in siting transmission for renewable electricity: SPDC formation, corporate ownership structure, corporate governance, and implementation costs.

1. FORMATION: WHO CREATES THE SPDC?

In the SPDC model for economic development takings proposed by Lehavi and Licht, a local author...
ment forms the SPDC and uses its power of eminent domain to aggregate land, which is then transferred to the SPDC. In the transmission-siting context, where approval for new transmission projects is typically conducted at the state level, there are several different options for entities to form an SPDC. These entities include the state public utility commission, other state agencies, the transmission developer, and local municipalities.

As the state agency typically responsible for approving transmission line siting, state PUCs would be a possible choice to initiate and form SPDCs for transmission land assembly. There are benefits to having the PUC create the SPDC, including knowledge of optimal siting and the consolidation of permitting and approval activity into one agency, a uniform approach within a state to transmission development, and superior interstate coordination abilities relative to local governments. However, PUCs themselves are not typically granted the authority to exercise the power of eminent domain. Instead, PUCs authorize the use of eminent domain power by utilities. Legislation would be needed to grant PUCs authority to create SPDCs and use eminent domain.

A different state agency that is currently vested with the power of eminent domain by state statute is another option for the creation of an SPDC. For example, state Departments of Transportation commonly have the power to condemn land under eminent domain. States vary considerably in the quantity and type of state entities granted eminent domain power by the state legislature. However, “[s]tate legislatures generally determine who may use eminent domain by delegating eminent domain authority to state or quasi-public entities, such as housing, transport, and urban renewal authorities, which may exercise that power only for the purpose for which it was established.” The statutory limitations on the exercise of eminent domain likely prevent a non-PUC state agency from establishing an SPDC. Creation of an SPDC probably falls outside the purposes for which eminent domain is permitted in statutory grants of authority for non-PUC state agencies. Legislation would also be needed to empower a non-PUC state agency to create an SPDC.

Alternatively, a transmission developer with an interest in siting a particular transmission corridor could create an SPDC, rather than using traditional eminent domain for land assembly. The PUC, in granting a Certificate of Need to the developer, could “condition” the grant of eminent domain authority on the formation of an SPDC, or the developer could request the use of an SPDC through incorporation into its Certificate of Need application. The developer formation option likely currently falls within the statutory authority of state PUCs to impose conditions during Certificate of Need reviews, if the PUC determined that creating an SPDC would serve the public interest mandate of the PUC. Determination of when an SPDC serves the public interest will be a fact-specific inquiry, based on when the deficiencies of traditional eminent domain, discussed supra in Section IIC, are expected to prevent a socially-beneficial project. PUCs would consider project-specific conditions to determine if opposition to traditional eminent domain is likely and whether an SPDC would be appropriate, including the size of the proposed transmission corridor, the number of affected landowners, and any articulated landowner concerns. A utility developing transmission also may be interested in initiating an

55 Lehavi & Licht, supra note 27, at 1734.
56 See Klass, supra note 1, at 1102.
57 Id.
59 Id.
60 Id. at 6 (emphasis added).
61 See, e.g. Minn. Stat. § 216B.243 (2013). The Minnesota statute governing Certificate of Need review for energy facilities by the PUC allows the issuance of the certificate to be “made contingent upon modifications required by the commission.” Id.
SPDC themselves for land aggregation when the utility expects traditional eminent domain to be costly or time-consuming.

A developer-initiated SPDC would undermine some of the goals of the SPDC process—there are agency concerns about whether landowner interests will be represented in an SPDC created by a developer if the developer controls the SPDC and is primarily interested in increasing its profit or minimizing its cost rather than looking out for the SPDC shareholders. The participation value of landowners could likewise be undercut if landowners felt the transmission siting process was controlled fully by the developer. However, these concerns could be mitigated through active PUC leadership during approval or conditioning of a developer-initiated SPDC. PUCs would actively review SPDC ownership structure, management structure, and anticipated cost, and condition its use on the meeting of these standards.

Finally, local municipalities could form transmission-siting SPDCs. Many municipalities currently have eminent domain power and could create the SPDC as a local development corporation. However, this creates a fractured approach across townships that could hamper land aggregation for transmission corridors that need to span larger distances. Local municipalities may also lack the political will to support development of any new transmission.

While each option carries its own set of challenges, the best solution appears to require state legislation to allow PUCs to exercise the power of eminent domain and form transmission SPDCs. SPDC formation by PUCs would take advantage of siting expertise, enable larger-scale projects, and avoid agency concerns. If legislation allowing PUCs to form SPDCs is not feasible, an alternative option is to allow developers to initiate SPDCs. While the developer-initiated approach does not capture all SPDC benefits, if actively reviewed by the PUC, it could still prove effective in aligning landowner and developer interests by giving landowners a financial stake in transmission development.

2. **SPDC Corporate Ownership Structure: Public or Private?**

As corporations with multiple shareholders, SPDCs must be either publicly listed or privately held. As a public corporation, securities are listed and traded on a stock exchange, and the corporation makes regular filings with the Securities and Exchange Commission. There are transparency benefits that arise from a public listing: required information disclosures to shareholders, the ability to freely trade shares, and clear market valuation of the SPDC through share price. However, there are also issues associated with a public listing: the cost and time of an Initial Public Offering (IPO). IPO expenses include SEC filings, due diligence review, and an underwriter fee; costs have been estimated at $5 million for a small IPO.

In contrast, forming a private corporation is comparatively low in cost and quick. Private ownership also has its drawbacks, however—valuation is not transparent because share trades occur in private rather than on a public stock exchange, and private ownership is capped at 2000 persons, or 500 persons who are not accredited investors. The costs of IPOs and the cap on private ownership suggest that SPDC ownership structure should depend on the size of a transmission land assembly project. Large projects, with many shareholders and higher value, should form publicly listed SPDCs. Smaller projects, with fewer than 500 shareholders and lower valuation, should use private SPDCs.

3. **CORPORATE GOVERNANCE OF THE SPDC: WHO MANAGES?**

The SPDC is a corporation with a limited purpose, formed strictly to aggregate land, but it still requires management to organize the sale of the transmission corridor for the greatest value supported by the market. The SPDC could be managed by either a shareholder-elected Board of Directors or by an appointed trustee. Directors who are directly accountable to shareholders may better represent shareholders’ interests, but are also vulnerable to agency issues, such as capture by a dominant shareholder (like a developer who has already purchased land on the open market). In contrast, an appointed trustee is not directly accountable to shareholders, which may lower landowner shareholders’ participation value. However, a trustee has a fiduciary duty to maximize landowner compensation in transmission siting.

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62 See Lehavi & Licht, supra note 27, at 1734.
64 Id.
66 Schwarcz, supra note 59, at 139.
68 See Lehavi & Licht, supra note 27, at 1741.
value of SPDC at sale.\textsuperscript{69} Given the importance of avoiding agency issues, an appointed trustee is the best manager for a SPDC.

\section*{4. IMPLEMENTATION COSTS OF THE SPDC: WHO PAYS?}

The costs associated with purchasing assembled land from an SPDC, including SPDC creation costs and payment of assembly value to shareholders, will be recovered in different ways depending on the type of entity that develops the transmission. State public utility commissions traditionally have authority to set retail rates that include the cost of transmission facilities for retail power (unless the state is in retail competition or the state’s utilities have joined a regional transmission organization), while FERC has jurisdiction over the transmission of wholesale electricity and unbundled retail electricity. Entities developing transmission can be either traditional utilities or merchant transmission companies.

For traditional integrated utilities, costs for transmission investments are typically recovered through the utility’s rate base, with the state public utility commission setting a “just and reasonable” rate that covers the utility’s expenses and cost of capital for retail power.\textsuperscript{70} The PUC sets customer rates based on the utility’s Annual Revenue Requirement. The Annual Revenue Requirement (ARR) is set to equal the sum of expenses (including operations and maintenance, taxes, and depreciation) and the rate base (RB) (the sum of all capital investment, less depreciation) multiplied by the rate of return (ROR) (the weighted rate of return on the utility’s debt and equity).\textsuperscript{71}

\[
ARR = \text{expenses} + (\text{RB}) \times (\text{ROR})
\]

For these traditional utilities, the cost of financing new transmission development and the actual development costs (including costs associated with SPDC model) would be calculated in the developer-utility’s rate base, either during construction or when new transmission becomes operational.\textsuperscript{72} The utility would thus be able to recover costs associated with the SPDC model through its rates.

Importantly, the costs of traditional eminent domain are also incorporated into a utility’s rates. Cost of delays and litigation around the use of eminent domain are also incorporated into the utility’s Annual Revenue Requirement, either as part of the rate base or as amortized cost.\textsuperscript{73} Eminent domain costs are recoverable long as decisions about the expenses are prudent and the resulting transmission is “used and useful.”\textsuperscript{74}

Merchant transmission companies are also likely to be able to recover the costs of both the SPDC model and traditional eminent domain through their rates, but for different reasons. Merchant transmission

\textsuperscript{69} Id. at 1742.


\textsuperscript{71} Id. at 217-18.

\textsuperscript{72} Id. at 233 n.68.

\textsuperscript{73} Id. at 253.

\textsuperscript{74} Id.
rates are negotiated directly with customers. Economically rational merchant companies will set rates that enable them to recover all costs of a transmission project.

To summarize, traditional utilities would be able to recover costs for both traditional eminent domain and SPDCs in their ARR, while merchant transmission companies could also recover both types of cost in their rates. In situations where the defects of traditional eminent domain would result in significant delay and litigation costs, SPDC costs could be lower and thus result in lower rates.

CONCLUSION

Costs of implementing SPDC procedures can be high, but for projects where issues with eminent domain prevent the development of new transmission needed to link renewable generation to load centers, SPDCs can be economically efficient by reducing costs associated with project delay and opposition through the alignment of landowner interests with transmission development.

75 See Federal Energy Regulatory Commission, Final Policy Statement on Allocation of Capacity on New Merchant Transmission Projects and New Cost-Based, Participant-Funded Transmission Projects, January 17, 2013, available at http://www.troutmansandersenergyreport.com/wp-content/uploads/2013/01/E-2.pdf. FERC allows merchant developers to negotiate wholesale rates with customers, as long as the negotiations satisfy four factors identified by FERC. The four factors are “(1) the justness and reasonableness of rates; (2) the potential for undue discrimination; (3) the potential for undue preference, including affiliate preference; and (4) regional reliability and operational efficiency requirements.” Id.