

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

Preliminary Permits for Wave, Current and)
Instream New Technology Hydropower) Docket No. RM07-8-000
Projects)

**COMMENTS OF
MORGAN STANLEY CAPITAL GROUP INC.**

Pursuant to the Commission's February 15, 2007 Notice of Inquiry in the above-captioned proceeding,¹ Morgan Stanley Capital Group Inc. ("MSCG") hereby submits its comments on the Commission's procedures concerning the treatment of preliminary permits under Part I of the Federal Power Act ("FPA") for wave, current and instream new technology hydropower projects ("New Technology Projects"). MSCG is a major trader and investor in the North American energy markets, encompassing both physical and derivative capabilities, and is authorized by the Commission to act as a power marketer engaging in sales for resale of electricity in interstate commerce at negotiated, market-based rates. MSCG is encouraged by recent advancements in harnessing ocean current and tidal hydrokinetic energy to generate power, and is currently considering trading and investment opportunities in this emerging industry. Because it plans to be an active participant in new technology hydropower projects, MSCG is keenly interested in the Commission's developing policies in this area.

In general, MSCG agrees with the Commission that there is a need to reevaluate how applications for preliminary permits are treated. As explained by commenters to date in this proceeding as well as at the Commission's December 6, 2006 Hydroelectric Infrastructure

¹ *Preliminary Permits for Wave, Current and Instream New Technology Hydropower Projects*, "Notice of Inquiry," IV FERC Stats. & Regs., ¶ 35,555 (2007) ("NOI").

Technical Conference,² reform of the preliminary permit process for New Technology Projects is necessary because of the flaws in that process as applied to New Technology Projects. The current process, which authorizes the issuance of preliminary permits to establish the permittee's license application priority, is not well-suited to New Technology Projects. That process was adopted at a time when traditional hydropower projects – dams – were necessarily limited in size and scope by the attendant watercourse. In contrast, New Technology Projects are generally not subject to such inherent limitations.

In some cases, New Technology Project permit applicants appear to be exploiting the flexibility afforded under the current process by requesting multiple permits without a reasonable intent of fully developing each, or by seeking unnecessarily large permit surface area designations, thereby banking sites to inhibit competition. These problems are compounded by the Commission's historically liberal approach to granting preliminary permits; as a result, priority in licensing promising sites may be awarded to an unproven few who succeed only in winning the "race" to file first. The priority and exclusivity represented by a preliminary permit constitute artificial barriers to investment in New Technology Projects, and will impede the development of this nascent industry. For these reasons, MSCG's preferred approach is for the Commission to refrain from awarding preliminary permits for future wave, current and instream hydropower projects.

In these comments, MSCG first identifies three major problems with the existing preliminary permit process. Based on these problems, we then argue that the Commission should refrain from issuing preliminary permits for new technology projects. Finally, if the

² Docket No. AD06-13-000.

Commission declines to adopt that approach, we urge the Commission to exercise a “stricter scrutiny” approach, and in that regard, we propose four criteria that the Commission should adopt under the stricter-scrutiny approach.

I. Problems With the Existing Preliminary Permit Process

MSCG recognizes the role that preliminary permits historically have played in securing the positions of traditional hydropower developers and acknowledges that such permits do not represent the Commission’s final authorization of construction activities or operations (as would a license). Nevertheless, preliminary permits can dramatically impact the near- and long-term deployment of wave, current and instream technology. The negative implications of “site-banking,” as detailed below, and the minimal demonstration of project viability required of permit applicants could inhibit the growth of this promising, yet nascent, industry.

A. Site-Banking Concerns

A preliminary permit grants the permittee priority in applying for a license for a hydropower project anywhere within the permit boundary. A rational, competing developer would refrain from expending resources to investigate suitable sites in the area within the boundaries of a preliminary permit, since such investment could ultimately be “trumped” by a license application filed by the preliminary permit-holder. The permittee therefore enjoys a *de facto* monopoly over the permit area – a monopoly that arises solely by virtue of holding the preliminary permit. This creates problems in the context of New Technology Projects because, unlike traditional hydropower projects (such as dams), target sites for this new technology are generally not self-limiting in size and scope. A New Technology Project permit applicant has an obvious incentive to expand the size and scope of its project for permit purposes in order to maximize the permit’s priority and exclusivity. In addition, no industry consensus has emerged

concerning acceptable permit area boundaries for these new technologies. Lacking such boundaries, the Commission has issued preliminary permits covering massive tracts of seafloor despite minimal showings of applicants' need for such reservations. Indeed, recent successful applicants have conceded that their project's actual "footprint" would likely occupy less than 0.1% of the study area requested, and argued only generally that the surrounding area was necessary to study current flows and geological and environmental conditions.³

The Commission's current preliminary permit process creates opportunities for developers to "bank" sites to eliminate competition, without any demonstration of technical or financial capability. Such banking represents an artificial barrier to investment in New Technology Projects, and could stifle new market entrants. It appears that some permittees have responsibly reserved only those areas likely to be directly utilized in project construction and operation activities.⁴ Nonetheless, until the Commission develops and enforces reasonable boundaries, conditions exist for wave and current hydropower applicants to exploit the preliminary permit process.

B. Insufficient Showing of Technical, Financial and Environmental Viability

As noted in the NOI, the Commission generally has not subjected preliminary permit applications to extensive scrutiny, reasoning that such permits merely facilitate an applicant's

³ See, e.g., *Red Circle Systems Corp.*, "Preliminary Permit Application – SeaGen Ft. Lauderdale," at 4-5, 8, Docket No. P-12498 (filed May 14, 2004) (requesting a 1,050 sq. mile study area); *Red Circle Systems Corp.*, "Preliminary Permit Application – SeaGen St. Lucie," at 4-5, 8, Docket No. P-12499 (filed May 14, 2004) (requesting a 1,050 sq. mile study area).

⁴ See, e.g., *Verdant Power, LLC*, "Application for Second Preliminary Permit for the Roosevelt Island Tidal Energy Hydropower Site," at Exhibit 1, ¶ 5, Docket No. P-12611 (filed Sept. 6, 2005) (requesting a 37 acre study area); *Tacoma Power*, "Application for Preliminary Permit for Tacoma Power's Narrows Tidal Energy Project," at 1, Docket No. P-12612 (filed Sept. 14, 2005) (requesting a 5.3 sq. mile study area).

investigation of a project's feasibility.⁵ MSCG believes that this approach is inappropriate for New Technology Projects. These technologies, while promising, are unproven in the U.S. energy markets. The Commission risks deterring, rather than promoting, investment in this industry by awarding preliminary permits (and their corresponding three-year study period) to applicants who offer little or no details concerning their capabilities or preparations to ensure a project's viability.⁶ If a permittee fails to seek a license at the end of the permit period due to insufficient financial or stakeholder support or inadequate prospects for potential power purchasers, competing developers will have irretrievably lost three years for study and development purposes. In such a situation, investors likely will be hesitant to back similar projects in the future and available capital will be diverted to other projects.

C. Potential for Lengthy Delay

MSCG also is concerned that preliminary permits might provide an avenue for a permittee to delay a project's completion while maintaining priority against competitors. Although the term of a preliminary permit is limited by statute to three years, MSCG notes that the Commission has, in at least one instance, effectively extended this period by issuing a second preliminary permit. In December 2005, the Commission granted Verdant Power's request for a

⁵ NOI at P 5; *see also Three Mile Falls Hydro, LLC*, 102 FERC ¶ 61,301, at P 6 (2003).

⁶ MSCG recognizes that permittees can supplement the information initially provided to the Commission through the submission of six-month progress reports. We note, however, that the robustness of these reports varies between permittees. Moreover, the Commission itself concedes that it "has not often exercised the right it reserves in all preliminary permits to cancel the permit." NOI at P 12. Permittees therefore have little real incentive to provide detailed reports.

second permit for its Roosevelt Island Tidal Energy project.⁷ While in this particular case the second permit may have been reasonable,⁸ it nevertheless illustrates a potential to avoid making a decision to seek a license within the three year timeframe intended by Congress, and in so doing frustrate potential competing developers.⁹

II. The Commission Should Decline to Issue Preliminary Permits for New Technology Projects

For the foregoing reasons, MSCG urges the Commission to abandon the practice of issuing preliminary permits for New Technology Projects. These permits are ill-tailored to this emerging industry, create artificial barriers to investment and new entry, and are more apt to reward filing speed over technical and financial capabilities. MSCG believes that market forces are better suited to determine the most efficient, best-positioned parties to seek a license for and develop potential wave, current and instream sites.

MSCG understands that certain parties are concerned that private investors will not commit capital towards studying sites without the “protection” offered by a preliminary permit.¹⁰ As a potential investor, MSCG unequivocally disagrees with this proposition. MSCG values developers that actively pursue potential projects, including studying the technical and environmental feasibility of a site and engaging relevant stakeholders (the host community,

⁷ *Verdant Power, LLC*, 113 FERC ¶ 62,193 (2005). Verdant’s first permit, obtained in September 2002, had expired in August 2005.

⁸ In this case, Verdant cited delays by other federal and state agencies with jurisdiction over aspects of its project.

⁹ MSCG appreciates the Commission’s recognition, in its Verdant Power order, that “successive permit[s] can warrant a greater standard of Commission oversight.” 113 FERC ¶ 62,193.

¹⁰ *See, e.g., FERC Hydroelectric Infrastructure Technical Conference*, Docket No. AD06-13-000, “Comments of Oceana Energy Company and Its Subsidiary Preliminary Permit Applicants,” at 2 (filed Dec. 20, 2006).

potential customers and partners, etc.), *before* seeking government authorizations. These efforts are the hallmarks of sound management and signal a commitment to the long-term success of the developer's project. Moreover, as a potential developer, MSCG believes that developers should compete based on the merits of their projects and their capabilities, rather than awarding a preference to the first developer who merely files for a permit. The current preliminary permit process misdirects developers away from sound practices and focuses their attention instead on being the "first in line" to receive the Commission's approval and its attendant three-year period of *de facto* exclusivity. The availability of preliminary permits thus encourages less rigorous pre-application efforts, which could undermine not only individual projects but this emerging industry as a whole. Eliminating preliminary permits will level the playing field for all competitors and will ensure that these new technologies will be deployed as expeditiously as possible.

III. If the Commission Continues Issuing Preliminary Permits, It Should Exercise Much Stricter Scrutiny

If the Commission is inclined to maintain the preliminary permit process for New Technology Projects, we urge the Commission to apply a "stricter scrutiny" approach to the granting and monitoring of preliminary permits. As discussed above, a number of factors render the Commission's historically liberal approach inappropriate for this emerging industry. MSCG therefore recommends the following improvements to the permit process for New Technology Projects:

A. Require Greater Content and Specificity in Permit Applications

Given the effect that a preliminary permit may have on the allocation of developers' and investors' resources, the Commission should not grant permits to applicants who offer only a

minimal showing of their technical capabilities, financial resources and prospects for project success. Applications should provide specific details on the anticipated project design, early stakeholder outreach efforts, financial arrangements, and reasonably anticipated potential conflicts (*e.g.*, endangered species/critical habitat concerns, impacts on the host community's economy, etc.). All of these factors will signal the seriousness of a project, and will tend to mitigate the artificial barrier created by the three-year exclusivity of a preliminary permit.

B. Scrutinize Requested Permit Areas

As discussed above, MSCG is concerned that the current preliminary permit process is vulnerable to "site-banking" by applicants as a means of eliminating competition. MSCG believes that the Commission should establish reasonably narrow geographic boundaries on a case-by-case basis for pending and future preliminary permit applications. Moreover, the Commission should presumptively reject technological, geologic and hydrologic uncertainties as purported justifications for excessively large permit areas; an applicant should, to the extent possible, address such concerns prior to seeking the Commission's approval. MSCG agrees with commenter Verdant Power, LLC that "[a]pplicants that are not prepared to engage or incapable of engaging in these substantial effort[s] have no business . . . applying for a preliminary permit in the first place."¹¹

¹¹ *FERC Hydroelectric Infrastructure Technical Conference*, Docket No. AD06-13-000, "Comments of Verdant Power in Response to Comments of Oceana Energy Company and Its Subsidiary Preliminary Permit Applicants," at 5 (filed Feb. 3, 2007).

C. Establish Specific Milestones

The Commission also should require permittees to achieve certain milestones demonstrating continuous progress towards licensing and ultimate project development.¹² Relevant accomplishments could include securing project financing, negotiating preliminary agreements with transmission line operators and power purchasers, community and stakeholder outreach efforts, engagement with other relevant federal and state agencies, and implementing, as appropriate, one or more demonstration projects to field-test the permit site. The Commission should encourage regular reporting on these milestones (such as every six months) and require a detailed update on achievements in each six-month progress report. The Commission should not hesitate to exercise its statutory authority to cancel a preliminary permit if a permittee does not demonstrate reasonable and timely progress towards achieving these milestones.

D. Shorten the Standard Permit Period to Eighteen Months

In conjunction with the establishment of specific milestones, the Commission also should reduce the standard term for preliminary permits from three years to eighteen months for New Technology Project permit applicants. MSCG agrees with commenter Ocean Renewable Energy Coalition that “[l]ocking up sites for three years without the demonstration of any real progress could prove fatal to this emerging industry.”¹³ In exceptional circumstances, the Commission could invite a permittee to re-apply at the conclusion of the eighteen-month period and thereby

¹² FPA Section 5 requires a preliminary permit to include “the conditions under which [license application] priority shall be maintained.” 16 U.S.C. § 798 (2000).

¹³ *FERC Hydroelectric Infrastructure Technical Conference*, Docket No. AD06-13-000, “OREC Proposed Framework for Issuing Licenses and Permits for Wave, Hydrokinetic, Current and Tidal Projects Under the Federal Power Act,” at 4 (filed Dec. 20, 2006).

maintain priority (capped at a total of three years from the initial permit),¹⁴ but only after demonstrating significant progress toward achieving its enumerated milestones and explaining why it was unable to complete the necessary activities within the original permit period.

IV. Conclusion

MSCG agrees with the Commission that wave, current and instream hydropower projects possess enormous potential to provide clean, renewable energy in the near future. The Commission must design a rational regulatory program to foster this exciting technology, and avoid creating and maintaining artificial barriers to investments in New Technology Projects. In MSCG's view, preliminary permits represent an unnecessary and harmful impediment to the emergence of this industry.

¹⁴ FPA Section 5 commits the preliminary permit period to the Commission's discretion, but limits the period to three years. *See* 16 U.S.C. § 798 (2000).

Wherefore, Morgan Stanley Capital Group Inc. requests that the Commission accept these comments and take such other actions as requested herein.

Respectfully submitted,

/s/ Keith R. McCrea

Keith R. McCrea

Daniel E. Frank

Gregory R. Staiti

Sutherland Asbill & Brennan LLP

1275 Pennsylvania Avenue, N.W.

Washington, DC 20004-2415

Tel.: 202-383-0100

Fax: 202-637-3593

Email: keith.mccrea@sablaw.com,

daniel.frank@sablaw.com,

gregory.staiti@sablaw.com

Attorneys for

Morgan Stanley Capital Group Inc.

April 30, 2007

Submission Contents

720209_3.DOC..... 1-11