

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Transmission Planning and Cost Allocation)
By Transmission Owning and Operating Public Utilities) Docket No. RM10-23-000

JOINT COMMENTS OF
AMERICAN CHEMISTRY COUNCIL, AMERICAN FOREST & PAPER
ASSOCIATION, AMERICAN PUBLIC POWER ASSOCIATION,
CALIFORNIA MUNICIPAL UTILITIES ASSOCIATION, CALIFORNIA PUBLIC
UTILITIES COMMISSION, ELECTRICITY CONSUMERS RESOURCE COUNCIL,
INDIANA UTILITY REGULATORY COMMISSION, MODESTO IRRIGATION
DISTRICT, MONTANA PUBLIC SERVICE COMMISSION, NATIONAL
ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES, NEW ENGLAND
CONFERENCE OF PUBLIC UTILITIES COMMISSIONERS, NEW HAMPSHIRE
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OLD DOMINION ELECTRIC COOPERATIVE, SACRAMENTO MUNICIPAL
UTILITY DISTRICT, SOUTH DAKOTA PUBLIC UTILITIES COMMISSION,
STATE OF MAINE, OFFICE OF THE PUBLIC ADVOCATE, TRANSMISSION
AGENCY OF NORTHERN CALIFORNIA, UTILITY REFORM NETWORK,
VERMONT DEPARTMENT OF PUBLIC SERVICE,
AND VERMONT PUBLIC SERVICE BOARD
ON TRANSMISSION RATE INCENTIVE AND COST ALLOCATION ISSUES

In accordance with the Commission’s June 17, 2010 “Notice of Proposed Rulemaking”¹ (“NOPR”) and its August 10, 2010 “Notice Extending Comment Period”² issued in the above-noted docket, a coalition of state public utility commissions, state consumer advocates, public power systems, rural electric cooperatives and end users comprised of the American Chemistry Council, the American Forest & Paper Association, the American Public Power Association, the California Municipal Utilities Association, the California Public Utilities Commission,

¹ 75 Fed. Reg. 37,884 (June 30, 2010).

² Available at: http://elibrary.ferc.gov:0/idmws/File_list.asp?document_id=13838812.

Electricity Consumers Resource Council, the Indiana Utility Regulatory Commission, the Modesto Irrigation District, the Montana Public Service Commission, the National Association of State Utility Consumer Advocates, the New England Conference of Public Utilities Commissioners, the New Hampshire Office of Consumer Advocate, the New Jersey Division of Rate Counsel, the New York State Public Service Commission, the Office of the Nevada Attorney General, Bureau of Consumer Protection, the Old Dominion Electric Cooperative, the Sacramento Municipal Utility District, the South Dakota Public Utilities Commission, the State of Maine, the Office of the Public Advocate, the Transmission Agency of Northern California, the Utility Reform Network, the Vermont Department of Public Service, and the Vermont Public Service Board (together, “Joint Commenters”), submit their joint comments regarding the interrelationship between the Commission’s proposal in the NOPR to amend the transmission cost allocation requirements previously established in Order No. 890³ and the Commission’s implementation of its transmission rate incentive policy first adopted in Order No. 679.⁴ In short, the Commission’s effort to remove barriers to transmission through its proposed cost allocation rules cannot be effectuated without revisiting its treatment of transmission rate incentives; higher transmission costs resulting from unnecessary incentive awards make cost allocation solutions much more difficult to reach. Joint Commenters call on the Commission to reevaluate its transmission rate incentive policy in any Final Rule issued in this docket, to ensure

³ *Preventing Undue Discrimination and Preference in Transmission Service*, Order No. 890, FERC Stats. & Regs. ¶ 31,241, *order on reh’g*, Order No. 890-A, FERC Stats. & Regs. ¶ 31,261 (2007), *order on reh’g*, Order No. 890-B, 123 FERC ¶ 61,299 (2008), *order on reh’g*, Order No. 890-C, 126 FERC ¶ 61,228 (2009), *order on clarification*, Order No. 890-D, 129 FERC ¶ 61,126 (2009).

⁴ *Promoting Transmission Investment Through Pricing Reform*, Order No. 679, FERC Stats. & Regs. ¶ 31,222 (2006), *order on reh’g*, Order No. 679-A, FERC Stats. & Regs. ¶ 31,236, *order on reh’g*, 119 FERC ¶ 61,062 (2007).

that end use consumers of electricity pay only just and reasonable transmission rates, as the Federal Power Act (“FPA”) requires.⁵

I. EXECUTIVE SUMMARY

The Joint Commenters are filing these comments to express their strong concerns with the Commission’s ongoing application of its transmission rate incentives policy first announced in Order No. 679 and its adverse impact on reaching transmission cost allocation solutions. The Joint Commenters do not oppose the granting of transmission rate incentives in circumstances where they are indeed required. But they are deeply concerned by the current direction of the Commission’s transmission rate incentive policy. The Commission states that the NOPR in this docket is intended to establish a closer link between transmission planning processes and cost allocation. To that end, the NOPR would require cost allocation methods for intraregional and interregional transmission facilities to satisfy newly established cost allocation principles. The Commission fails to note, however, the clear causal connection between the issue of transmission cost allocation and the ongoing implementation of the Commission’s transmission rate incentive policy. The Commission says in the NOPR (at P 164) that “[t]he cost of transmission facilities must be allocated to those within the transmission planning region that benefit from those facilities in a manner that is at least roughly commensurate with estimated benefits.” *When excessive transmission rate incentives are awarded to project sponsors, no one benefits from the associated costs except the recipients of the dollars.* The Commission therefore needs to

⁵ Many of the Joint Commenters are also filing individual comments in this docket, and/or joining in additional comments being filed by other groups. The fact that Joint Commenters have come together to express their strong concerns with the Commission’s transmission rate incentive policy should not be taken as an indication that any of the Joint Commenters share other positions expressed in other sets of comments being filed by other Joint Commenters in this docket.

reevaluate its transmission rate incentive policy in tandem with its review of transmission cost allocation issues in this proceeding.

The Commission decided in Order No. 679 to offer a smorgasbord of transmission rate incentives to public utility transmission owners, including rate of return on equity adders, recovery of construction work in progress, hypothetical capital structures, accelerated depreciation, and recovery of abandoned facilities costs. Transmission project developers have not been shy about helping themselves. Moreover, the Commission, in acting case-by-case on specific applications, has not taken a sufficiently disciplined approach to awarding transmission rate incentives. The granting of generous transmission rate incentives has accordingly become the “new normal” standard for transmission ratemaking at the Commission. Transmission customers as a result stand to pay a substantial and unjustified premium for the transmission service they should be getting for their “normal rates.” The essential purpose of incentives—to bring about change that would not occur without them—has effectively been destroyed.

The Joint Commenters therefore urge the Commission to undertake as part of any Final Rule in this docket a full review of its transmission rate incentives policy, and after such review, to adopt a revised policy that limits the granting of incentives: (1) only to extraordinary transmission projects that are found to be needed and that would not be constructed but for the granting of such incentives; and (2) only to a reasonable package of incentive measures that, taken together, reduce the risk of the project to acceptable levels for both project applicants and end use consumers, without resulting in unjust and unreasonable rates.

II. JOINT COMMENTERS’ INTERESTS

The Joint Commenters are a diverse group composed of state public utility commissions, industrial users of electricity, public power systems, consumer advocates, rural electric cooperatives, and/or trade associations representing such entities. All of them, however, share

the conviction that end use consumers should pay only just and reasonable rates for transmission service under the Federal Power Act (“FPA”), and that the Commission’s statutory duty is to ensure consumers are afforded “a complete, permanent and effective bond of protection from excessive rates and charges.”⁶ They have come together to file joint comments in this docket to express their strong concerns with the Commission’s ongoing application of its transmission rate incentives policy first announced in Order No. 679 and the adverse impact this policy has on the ability of parties to reach transmission cost allocation solutions. While the Joint Commenters are not opposed to the granting of transmission rate incentives in circumstances where they are indeed required, they are deeply concerned by the current direction of the Commission’s transmission rate incentive policy.⁷ To put it bluntly, the Commission has gone astray in applying that policy. The granting of transmission rate incentives, rather than being reserved for those cases in which incentives are truly needed to move a transmission project forward, are now being granted routinely. Moreover, the packages of incentives granted, taken together, go far beyond what is required to reduce the risk of a transmission project to reasonable levels. The Commission accordingly needs to reexamine and reorient its policy to balance the financial needs of project sponsors with its statutory obligation to consumers to keep rates at just and reasonable levels. Failure to revisit this issue in this docket will greatly complicate the Commission’s efforts to develop a workable transmission cost allocation regime.

⁶ *Atlantic Refining Co. v. Public Service Commission*, 360 U.S. 378, 388 (1959).

⁷ *See*, for example, the National Association of State Utility Consumer Advocates’ resolution on this issue, which can be found at: <http://www.nasuca.org/archive/res/index.resolutions.php>.

III. COMMUNICATIONS

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IV. COMMENTS

The Commission requests comments on its proposal to amend the transmission planning and cost allocation requirements established in Order No. 890. The Commission states that its proposed changes are intended to ensure that FERC-jurisdictional transmission services are provided on a basis that is just, reasonable and not unduly discriminatory or preferential. With respect to transmission cost allocation, the Commission states that the proposed rule is intended

to establish a closer link between transmission planning processes and cost allocation. It would require cost allocation methods for intraregional and interregional transmission facilities to satisfy newly established cost allocation principles. NOPR at P 5.

As the Commission itself acknowledges, transmission cost allocation is no easy task. At NOPR P 152, the Commission notes that “challenges associated with allocating the cost of transmission appear to have become more acute as the need for transmission infrastructure has grown.” It observes that “cost allocation within RTO or ISO regions, particularly those that encompass several states, is often contentious and prone to litigation because it is difficult to reach an allocation of costs that is perceived as fair.” *Id.*

The Commission, however, has failed to note the clear causal connection between the issue of transmission cost allocation and its ongoing implementation of its transmission rate incentive policy first promulgated in Order No. 679. But the United States Court of Appeals for the Seventh Circuit has identified the connection. “No doubt,” it said, “the more a transmission facility costs, and therefore the greater the stakes in a dispute between potential contributors to that cost, the more litigation there is likely to be.”⁸ When the Commission approves lucrative transmission rate incentive packages for projects that result in very substantial additional facilities costs to transmission customers (as it now does routinely), those customers are less likely to agree to absorb those costs. The Commission says in the NOPR (at P 164) that “[t]he cost of transmission facilities must be allocated to those within the transmission planning region that benefit from those facilities in a manner that is at least roughly commensurate with estimated benefits.” *But when excessive transmission rate incentives are awarded to project sponsors, no one benefits from the associated costs except the recipients of the dollars.* This, in a

⁸ *Illinois Commerce Commission v. FERC*, 576 F. 3d 470, 475-76(7th Cir. 2009)(“*Commonwealth Edison*”).

nutshell, is why the Commission needs to reevaluate its transmission rate incentive policy in tandem with its review of transmission cost allocation issues in this proceeding.

When the Commission implemented new Section 219 of the FPA⁹ in Order No. 679, adding new 18 C.F.R. § 35.35 to its regulations, it made clear that in so doing, it was not implicitly repealing the statutory FPA requirement that rates must be just and reasonable. It stated (at P 2):

. . . [T]he Rule does not grant incentives to any public utility but instead permits an applicant to tailor its proposed incentives to the type of transmission investments being made and to demonstrate that its proposal meets the requirements of section 219. Further, under the Rule, the Commission will permit incentives only if the incentive package as a whole results in a just and reasonable rate. For example, an incentive rate of return sought by an applicant must be within a range of reasonable returns and the rate proposal as a whole must be within the zone of reasonableness before it will be approved.

Indeed, Section 219 of the FPA, which directed the Commission to undertake the rulemaking that resulted in Order No. 679, makes clear in Section 219(d) that the overall rates awarded must still meet the FPA statutory standard:

(d) All rates approved under the rules adopted pursuant to this section, including any revisions to the rules, are subject to the requirements of sections [824d](#) and [824e](#) of this title that all rates, charges, terms, and conditions be just and reasonable and not unduly discriminatory or preferential.

Unfortunately, the Commission nonetheless decided in Order No. 679 to offer a smorgasbord of transmission rate incentives to public utility transmission owners, including rate of return on equity (“ROE”) adders, recovery of construction work in progress (“CWIP”), hypothetical capital structures, accelerated depreciation, and recovery of abandoned facilities

⁹ Section 219 of the FPA was enacted as part of the Energy Policy Act of 2005 (“EPA 2005”) Pub. L. No. 109-58, § 1241, 119 Stat. 594, 315 and 1283 (2005). It required the Commission to “establish, by rule, incentive-based . . . rate treatments . . . for the purpose of benefiting consumers by ensuring reliability and reducing the cost of delivered power by reducing transmission congestion.”

costs. It did require applicants, in addition to satisfying the Section 219 requirement of ensuring reliability and/or reducing the cost of delivered power by reducing congestion, to demonstrate that there is a “nexus” between the incentive sought and the investment being made. Consumer-side interests, however, argued on rehearing of Order No. 679 that this “nexus” test was insufficient and too vague to protect consumers. In response, the Commission in Order No. 679-A clarified that the nexus test is met when an applicant demonstrates that the total package of incentives requested is “tailored to address the demonstrable risks or challenges faced by the applicant.”¹⁰ The Commission noted that this nexus test is fact-specific and requires the Commission to review each application on a case-by-case basis.

In the years since Order No. 679 was issued, the concerns of consumer-side interests expressed during the rulemaking have proven to be amply merited. Transmission project developers have not been shy about helping themselves to the incentives smorgasbord. Moreover, the Commission in acting case-by-case has not taken a sufficiently disciplined approach to awarding transmission rate incentives. In 2007-2008, two of then-sitting FERC Commissioners, Suedeen Kelly and Jon Wellinghoff, issued a series of strong dissents to Commission orders granting transmission rate incentives for various transmission projects.¹¹ In one of her dissents, Commissioner Kelly stated:

Incentives are to be made available to those special projects that face the types of unique or excessive risks or challenges that incentives can address. [Footnote omitted.] If we award incentives to projects indiscriminately, i.e. to projects that do not face unique or excessive risks or challenges, then “incentive ratemaking” just becomes the “new, normal” rate recovery. I believe this would be unjust and unreasonable because it would result in transmission customers having to pay a

¹⁰ Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 40.

¹¹ See, e.g., *Baltimore Gas and Electric Co.*, 121 FERC ¶ 61,167 (2007); *PPL Electric Utilities Corporation, et al.*, 123 FERC ¶ 61,068 (2008); *Bangor Hydro-Electric Co., et al.*, 122 FERC ¶ 61,265 (2008).

premium for the type of service they would, and should, get for their normal rates. Also it would ultimately destroy the purpose of incentives, which is to provide a special spur to bring about change that would likely not occur without them.¹²

Joint Commenters believe that Commissioner Kelly's prediction has in fact come true. The granting of generous transmission rate incentives has indeed become the "new normal" standard for transmission ratemaking at the Commission. Transmission customers as a result stand to pay a substantial and unjustified premium for the transmission service they should be getting for their "normal rates." The essential purpose of incentives—to spur new transmission investment that would not occur otherwise—has effectively been destroyed.

The Commission now routinely grants to transmission project developers a wide variety of generous transmission incentives – one on top of the other – ROE adders, accelerated depreciation, abandoned plant cost recovery, CWIP and formula rates, without any systematic review of the need for these multiple incentives and how they interact in ratemaking.¹³

Exacerbating the problem is that incentives such as ROE adders have been allowed to apply to

¹² *Commonwealth Edison Co., et al.*, 122 FERC ¶ 61,037 (2008), Kelly dissent at 1.

¹³ For example, the Commission in the past had observed that the availability of formula rates reduced the financial risks public utilities faced and was viewed as a factor that should reduce a utility's return allowance. *See, e.g., Northeast Utilities Service Co. (Re Public Service Company of New Hampshire)*, 56 FERC ¶ 61,269 at p. 62,053 (1991); *Indiana & Michigan Power Co.*, 4 FERC ¶ 61,316 at p. 61,739 (1978); *South Carolina Generating Co.*, 40 FERC ¶ 61,116 at p. 61,311 (1987). As the Commission explained in *Indiana and Michigan Power Co., supra*, a cost-of-service tariff:

Permits immediate recovery of any increase in costs, thus limiting [the utility's] risk and minimizing not only the risk of regulatory lag, but also the risk of disapproval. It will automatically make its allowed rate of return on equity regardless of whether it delivers the power or not. The steady stream of revenues from such an arrangement provides the company with a very real advantage over those utilities not operating under similar cost-of-service tariffs.

4 FERC at p. 61,739. This risk factor, the Commission has held, justifies a lower return allowance. *Id.* Yet, under the Commission's recent practice, incentive adders have been given to public utilities that already possess formula rates without so much as a nod to the significance of this factor.

the ultimate costs of the projects, not the project sponsors' estimated cost of the projects. This gives transmission project developers the perverse incentive to bring their projects in over-budget, since they will earn a bonus return for doing so.

For example, in New England, approved Commission incentive adders apply to actual project costs, not the estimates of project costs presented to the Commission at the time the incentive adders were requested. Consumers, as a result, will pay more than an additional \$100 million in adder charges because qualified projects are running double or more their original estimated costs.¹⁴ Under the Commission's policy, the sole qualifying criteria for the adders was whether the projects had been approved in the New England planning process; the estimated cost was irrelevant.¹⁵

Similarly, in PJM, rather than make a detailed analysis of whether projects meet the requirement to demonstrate that they will provide reliability benefits and are non-routine, the Commission has relied excessively – in some cases almost solely – on whether a project has been included in PJM's Regional Transmission Expansion Plan ("RTEP"). The result of the Commission's near automatic assumption that projects that were included in the RTEP meet the Order No. 679 requirement to ensure reliability benefits or reduce the cost of delivered power by reducing congestion is that millions of dollars in adders are collected for projects that might not convey any such reliability or congestion benefits. Moreover, the Commission's determination in *Baltimore Gas and Electric Co.*, 120 FERC ¶ 61,084; *order on reh'g*, 122 FERC ¶ 61,034

¹⁴ See, *New England Conference of Public Utilities Commissioners, Inc. v. Bangor Hydro-Electric Co.* Docket No. EL08-69, Attachment A (filed June 12, 2008).

¹⁵ *New England Conference of Public Utilities Commissioners, Inc. v. Bangor Hydro-Electric Co.*, 124 FERC ¶ 61,291 (2008) at P 44 (*reh'g pending*) ("the Commission authorized the incentive in Opinion No. 489 without reference to the cost estimates of specific projects and not on the basis of any criteria apart from their RTEP status").

(2008) “BG&”) that PJM RTEP baseline projects should be deemed to meet the Order No. 679 nexus requirement has been relied upon to the exclusion of reasoned analysis or even explanation by the Commission. This is despite the fact that the Commission subsequently clarified that *BG&E* does not mean that projects in PJM's RTEP will qualify automatically for incentives.¹⁶ For example, in a proceeding regarding Virginia Electric and Power Company's request for incentive rate treatment, the Commission found that elements of the Order No. 679 incentive rate requirements were met simply because projects were included as PJM RTEP baseline projects.¹⁷ This has led to several million dollars in incentives that were not warranted, or at least not sufficiently reviewed and explained by the Commission.

The result is that in many cases, transmission project developers have been granted rate incentive packages (in many instances over the strong objection of those being asked to pay them) that in the Joint Commenters' view substantially exceed the incentives that would result in just and reasonable rates. Among these cases are:

Green Power Express LP, Docket No. ER09-681-000, 127 FERC ¶ 61,031 (2009)
(Applicant requested: (1) recovery of costs of abandoned facilities; (2) deferred recovery for start-up, development and pre-construction costs through the creation of regulatory assets; (3) 100 percent CWIP in rate base; (4) a hypothetical capital structure of 60 percent equity and 40 percent debt; and (5) a 160 basis point incentive Return on Equity (ROE) adder (50 basis points for participating in a Regional Transmission Organization (RTO), 100 basis points for independence, and 10 basis points for the risks and challenges of the Project), for an overall ROE of 12.38 percent, and (6) a formula rate structure under which the costs of the Project would ultimately be recoverable through the applicable open access transmission tariffs of Midwest Independent Transmission System Operator, Inc. (Midwest ISO) and PJM Interconnection, L.L.C. (PJM). The Commission granted all requested incentives except for the formula rate request, which was set for hearing/settlement proceedings.)

¹⁶ *Commonwealth Edison Co.*, 124 FERC ¶ 61,231 (2008).

¹⁷ *Virginia Electric and Power Co.*, 124 FERC ¶ 61,207 (2008), *reh'g pending*.

Green Energy Express LLC, Docket No. EL09-74-000, 129 FERC ¶ 61,165 (2009) (Applicant sought: (1) deferred recovery of pre-commercial expenses; (2) inclusion of 100 percent of CWIP in rate base; (3) abandoned plant recovery; (4) an ROE adder of 50 basis points for participation in a qualifying Transmission Organization; (5) an ROE adder of 100 basis points in recognition of Green Energy's status as a transco; (6) an ROE adder of 50 basis points to otherwise compensate for the unique risks and challenges facing the Project and Green Energy's investors; and (7) a hypothetical capital structure of 50 percent equity and 50 percent debt until the Project was placed in service. The Commission conditionally granted the Applicant's request for these incentives, conditioned on it submitting a filing that met certain criteria set out in the CAISO's planning process. Commissioner Kelly dissented from the grant of the 50 basis point ROE adder.)

Bangor Hydro-Electric Co., et al, Docket No. ER04-157, 117 FERC ¶ 61,129 (2006) ("Opinion No. 489"), *affirmed, Connecticut Dept. of Public Utility Control v. FERC*, 569 F.3d 477 (D. C. Cir. 2009). (Applicants, already operating under formula rates and under a contractual obligation to build new transmission facilities, were awarded a 100 basis point adder for new transmission projects. At the time the Commission approved the adder, the expected cost to consumers was \$148 million, but cost overruns – to which the adder also applies -- have nearly doubled the cost of the adder. *See, New England Conference of Public Utility Commissioners et al. v. Bangor Hydro-Electric Co., et al*, Docket No. EL08-69, Complaint at 1-2, 11 (filed June 12, 2008, *complaint denied, New England Conference of Public Utilities Commissioners, Inc. v. Bangor Hydro-Electric Co., et al.*, 124 FERC ¶ 61,291 (2008) (*rehearing pending*)).

Virginia Electric and Power Co., 124 FERC ¶ 61,207 (2008), *reh'g pending* (FERC granted applicants' request for 150 basis point adders for four projects and 125 basis point incentive adders for an additional seven projects. The projects for which incentive rate treatment was granted include several projects that were routine in nature, as well as a project that had not yet been approved in the PJM RTEP, and for which there was an insufficient demonstration of financial risk.)

Baltimore Gas and Electric Company - Mid-Atlantic Power Pathway ("MAPP"), Docket No. ER09-745-000, 127 FERC ¶ 61,201 (2009) (Applicant requested: (1) 150 basis point adder to its authorized Base ROE of 11.30 percent, for an overall ROE of 12.8 percent; and (2) abandoned plant recovery. Applicant's portion of the MAPP project was 10.4 miles, or about 4.5%, of the entire 230-mile MAPP project. In addition, Applicant's portion of the MAPP project (i) was located entirely within Applicant's existing right-of-way and within a single jurisdiction; (ii) would not be constructed by the Applicant; and, (iii) involved construction of a "traditional" overhead transmission line, unlike the rest of the MAPP project, which involved the use HVDC technology as well as construction over or under the Chesapeake Bay and Potomac River and across the Delmarva Peninsula on which are located many square miles of wetlands. The Commission granted all

requested incentives. Commissioner Kelly dissented from the grant of the 150 basis point ROE adder.)

Potomac-Appalachian Transmission Highline (“PATH”), Docket No. ER08-386, 122 FERC ¶ 61,188 (2008) (Applicant sought: (1) 50 basis point adder to authorized ROE for membership in qualifying Regional Transmission Organization; (2) approval of ROE at the high end of the zone of reasonableness or alternatively, approval of a 150 basis point adder (separate and in addition to the RTO membership adder) to result in an overall ROE of 14.3 percent; (3) approval to include 100 percent CWIP in rate base; (4) amortization of development (pre-commercial) costs over 60 months; (5) hypothetical capital structure of 50 percent equity and 50 percent debt until completion of construction of the PATH project; and (6) abandoned plant recovery. The Commission granted all requested incentives (including a 14.3 percent overall ROE), except for the formula rate request, which was set for hearing/settlement proceedings. Commissioner Kelly dissented from the Commission’s decision to establish an ROE directly in the order rather than set the ROE determination for evidentiary hearing. Then-Commissioner Wellinghoff also dissented from the majority’s decision to grant PATH an ROE of 14.3 percent. Requests for rehearing of the Commission’s decision in PATH remain pending.)

Transbay Cable, LLC, Docket No. ER05-985-000, 112 FERC ¶ 61,095 (2005) (Applicant sought and received through approved Rate Principles: (1) a 13.5% post-tax Return on Equity, significantly in excess of the prevailing returns earned by major Participating Transmission Owners within the California Independent System Operator Corporation; and (2) a hypothetical capital structure of 50 percent equity and 50 percent debt for the first three years of the project’s commercial operation, when the actual capital structure was estimated by parties to be approximately 70 percent debt and 30 percent equity. Subsequently, in Docket No. ER10-116-000, the Commission did reject Transbay’s additional request for a 50 basis points adder for placing the facility under the operational control of an RTO (132 FERC ¶61,083 (2010)). It is also notable that the incentives are now applied to project costs that have ballooned from \$300 million at the time of CAISO planning approval, to \$521 million net plant in service as per Transbay’s own rate filings.

The prospect of paying for these multiple incentives can cause resistance by transmission customers and consumer representatives to otherwise critical transmission projects and lead to protracted litigation, particularly where cost allocation debates turn to the total dollars involved in these projects and how, and from whom, these costs will be recovered. Given such incentive rate awards, it is no surprise that the Commission has observed that “challenges associated with

allocating the cost of transmission appear to have become more acute as the need for transmission infrastructure has grown.” NOPR at P 152. While it is indisputable that additional transmission infrastructure is needed, the Commission’s failure to keep the costs of that additional infrastructure within reasonable bounds is contributing to a groundswell of opposition to the allocation of the resulting costs of such projects.

The problem is further exacerbated by the Commission’s seeming lack of understanding that the financial ground has moved beneath its feet. Since the issuance of Order No. 679, conditions in the United States’ (indeed the world’s) economy have changed profoundly. The Nation has undergone its most severe economic contraction since the Great Depression. Interest rates are at historic lows, and unemployment is over 10 percent. Yet the Commission appears not to have reexamined its policy of granting very generous ROEs notwithstanding these fundamental changes in economic conditions. Simply put, the rate of return needed to attract investment in a long-lived asset that is used to provide a monopoly service is less than it was a few years ago. The Commission needs to acknowledge this reality.

Finally, the Commission should revisit two features of its 1992 Incentive Rates Policy Statement:¹⁸ (1) the requirement that incentive rate mechanisms be symmetrical (*i.e.*, that they offer both upside rewards to applicants *and* downside risks for poor performance); and (2) the requirement that applicants quantify -- at least in some way -- the benefits to ratepayers if the incentive payment is awarded. What the Commission said about regulatory symmetry is as true today as it was in 1992:

Incentive mechanisms should be designed to reward utilities that succeed in reducing costs, expanding services, and streamlining operations. At the same time, incentive regulation should be designed to penalize utilities that fail to

¹⁸ *Policy Statement on Incentive Regulation*, 61 FERC ¶61,168 (1992).

achieve these efficiencies -- opportunities for reward should be offset by a symmetric downside risk.¹⁹

Moreover, the requirement that Applicants quantify the benefits to ratepayers from their proposals is equally valid today. Commenting on the inherent difficulty in quantifying the benefits of an incentive proposal -- difficulties no greater than measuring the proportionate benefits of a transmission expansion as required under the NOPR -- the Commission had this to say:

The Commission remains convinced that benefits to consumers must be quantifiable even though the task is admittedly a difficult one. All proposals must include a quantified estimate of the consumer benefits compared to cost-of-service regulation (i.e., a comparison of projected cost-of-service rates to prospective rates under the proposed incentive rate mechanism), and a realistic estimate of the program's prospects for success and the risks of failure. The projected cost-of-service rates will serve as an overall cap on incentive rate increases to limit consumer risk. The cap must be designed to ensure that the incentive rate is no higher than it otherwise would have been under the projected traditional cost-of-service ratemaking. "Projected cost of service" simply means an annual estimate of the cost of service that the utility would otherwise expect to incur during the effective time period of its incentive rate proposal. If the utility proposed a five-year period, it would be required to include in its application with the Commission a comparison of expected incentive rates to the expected cost of service rates that it would otherwise propose to base its rates under traditional ratemaking.²⁰

The Commission also made clear that the principles it articulated in its 1992 Policy Statement applied to all of the industries it regulated:

The fact that incentive regulation may not play an equal role in regulating gas and oil pipelines and electric utilities, however, does not mean that general principles for incentive regulation should be tailored in any special way for each regulated firm. Instead, the Commission suggests a range of mechanisms so that specific proposals can be flexibly adjusted to address particular circumstances of individual utilities. Certainly the Commission does not expect incentive regulation to have a prominent role in setting rates for utilities where competition has

¹⁹ *Id.* at p. 61,590.

²⁰ *Id.* at p. 61,586 (internal citations omitted).

become a major force or where the Commission regulates a small portion of a utility's revenues.²¹

To sum up: if the Commission wishes to solve the transmission cost allocation conundrum, it must also address the issue of transmission rate incentive packages that unreasonably inflate transmission revenue requirements and operate only in favor of project applicants. Failure to do so will result in continued contentious litigation over the allocation of transmission costs, in part because those being asked to pay such costs will not concede that the overall costs they are being asked to pay are indeed just and reasonable, as the Federal Power Act requires.

WHEREFORE, Joint Commenters urge the Commission to undertake as part of any Final Rule in this docket a full review of its transmission rate incentives policy, and after such review, to adopt a revised policy that limits the granting of incentives only to: (1) extraordinary transmission projects that are found to be needed and that would not be constructed but for the granting of such incentives; and (2) a reasonable package of incentive measures that, taken together, reduce the risk of the project to acceptable levels for both project applicants and end use consumers, without resulting in unjust and unreasonable rates.

²¹ *Id.* at p. 61,586 (internal citations omitted).

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September 29, 2010