UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Promoting Transmission Investment Through Pricing Reform	**)** **)**	**Docket No. RM11-26-000**

COMMENTS OF THE ORGANIZATION OF MISO STATES

Pursuant to the Federal Energy Regulatory Commission's ("Commission") Notice of Inquiry ("NOI") issued on May 19, 2011, and the Notice Extending Comment Period issued on June 14, 2011, the Organization of MISO States ("OMS") respectfully submits the following comments regarding the Commission's transmission incentive regulations and policies.

I. INTRODUCTION

The Commission states that it has been nearly five years since rules were promulgated by the Commission in Order No. 679 to implement the directives of section 1241 of the Energy Policy Act of 2005, which added a new section 219 to the Federal Power Act ("FPA").[1] In the time since the issuance of those rules, the Commission has received over seventy-five requests for transmission incentives. Citing changes in the electric industry, the Commission's experience to date in applying Order No. 679, and the ongoing need to ensure that incentive regulations and policies are encouraging the development of transmission infrastructure in a manner consistent with FPA sections 219 and 205 and 206, the Commission issued its NOI on transmission incentive regulations and policies.[2] In the NOI, the Commission poses seventy-four specific questions regarding its transmission incentives and regulations for which it seeks input from interested parties. These comments are limited to the Commission's incentive policies with

[1] NOI, at P 1.
[2] NOI, at P 2.

respect to transmission-owning companies operating within regional transmission organizations ("RTOs") and in particular, the Midwest ISO ("MISO"). Given the nature of its organization and purpose, the OMS is not herein offering any advice or making any recommendations regarding incentive rate policies for non-RTO areas.

To that end, the OMS offers the following comments, which include the following advice and recommendations. These issues, as well as other issues, are discussed in more detail in Section II of these comments.

(1) The Commission should adopt a mechanism to promote project cost containment and project schedule containment.

In these comments, the OMS recommends that the Commission adopt a two-step process for applicants seeking transmission incentives. The first step focuses on addressing financial barriers that are preventing the applicant from raising the capital necessary to finance the transmission project. The second step focuses on cost and schedule containment by tying return on equity ("ROE") bonuses and penalties to the applicant's ability to reasonably restrain project costs to a pre-established definitive cost estimate.

(2) The Commission must focus its incentive rate policy on the benefits it produces for electricity consumers as required by section 219(a).

Section 219(a) of the FPA requires the Commission to establish an incentives policy for the purpose of improving reliability and reducing congestion <u>for the purpose of benefiting consumers</u>.[3] Accordingly, the focus of incentive rate policy reform must be on benefiting consumers.

(3) When considering transmission rate incentive applications, the Commission should closely examine the types of barriers faced by the applicant and tailor the incentives granted to the barriers faced.

[3] Section 219 of the Federal Power Act at 16 U.S.C. 824s(a).

Distinguishing between the financial and regulatory barriers would permit the Commission to tailor the incentives to best address the challenges of the proposed transmission development while ensuring compliance with section 219 of the FPA. Particular incentives or combinations are well-suited to help overcome certain types of barriers that one applicant may be facing and different incentives or combinations are well-suited to help overcome other types of barriers that another applicant may be facing.

(4) Reliability projects should not receive incentives.

As a general rule, the Commission should not grant incentives for reliability projects, as the construction of these projects is generally required to comply with reliability standards set by the North American Electric Reliability Corporation (”NERC”) and recognized reliability authorities. This is especially true in the case of RTOs, as the build is effectively required under the conditions of RTO membership. In unique cases where financial barriers are an issue, it may be appropriate to grant limited incentives for reliability projects. In addition, the criteria for evaluating reliability projects should be cost-effectiveness (i.e. meeting the reliability requirement at lowest cost) rather than net-benefits (i.e. benefits of a project exceed the project’s costs).

(5) Projects that are undertaken under a contractual obligation should generally not be eligible for incentives.

(6) ROE incentive adders should not be granted to address non-financial barriers to project development.

Challenges facing developers such as regulatory, siting, or environmental obstacles cannot be cured by granting ROE adders. Consequently, it would not be reasonable to grant ROE adders for that purpose.

(7) The Commission's reliance on the rebuttable presumption technique in incentives cases is flawed and should be eliminated.

The OMS does not believe that the Commission's policy of using rebuttable presumptions in transmission incentive cases has been working well. Not only is this approach inconsistent with the way in which section 205 filings are normally processed, but it inappropriately places the burden of proof on stakeholders and protestors rather than applicants. Rather than continue with the rebuttable presumption technique, the Commission should instead issue a rule listing the standards or conditions that a prospective applicant will be required to meet in order to be eligible for transmission incentives pursuant to section 219 of the FPA. At that point, all applications for incentive rate treatment would be based on an independent showing by the applicants.

(8) A Meaningful net-benefits test must be developed and implemented for economic efficiency projects.

Section 219 of the FPA requires the Commission to provide incentives "for the purpose of benefitting consumers by ensuring reliability and reducing the cost of delivered power by reducing transmission congestion." In order to comply with section 219 of the FPA, the Commission needs to implement a meaningful net-benefits test to ensure that consumers benefit from a transmission project that receives transmission incentives pursuant to section 219 of the FPA. The OMS believes that benefit/cost analysis can be a very important tool in developing rates that are just and reasonable since this type of analysis assists in ensuring that costs are not only just and reasonable, but commensurate with the benefits that are received by electricity consumers (at least in the aggregate).

II. QUESTIONS AND RESPONSES

A. General Questions Regarding Incentive Rate Policy

Q1. What have been the effects of the incentives policies adopted in Order No. 679 with respect to the goals set forth in section 219?[4]

Q2. Are the Commission's incentives policies appropriately promoting investment in transmission infrastructure in accordance with section 219?[5]

Given that the Commission's current incentive rate policy does not require applicants to make any definitive showing that electricity consumers will benefit and does not collect ongoing data regarding this key objective in section 219, these questions cannot be answered with any real certainty or without speculation. One objective of incentive rate policy reform should be to establish relevant base-lines and to collect project data to enable the Commission to evaluate whether its transmission rate incentive policy and the application of that policy to specific cases is actually advancing the goals set forth in section 219.

Q3. Some barriers to construction of new transmission facilities fall outside of the scope of the Commission's jurisdiction. How do the Commission's incentive policies affect such barriers?[6]

New transmission facility construction often requires state regulatory certification approval. In cases where incentives have no material effect on the developer's decision to build or not build, granting the incentives only increases the risks that the state certificate would not be issued. This type of barrier is likely to be most apparent in cases involving projects that are not needed to meet reliability requirements, but may be driven by other issues. The strength of this barrier may be increased by the Commission's incentive policy if granting incentives is

[4] NOI, at P 15.
[5] NOI, at P 15.
[6] NOI, at P 15.

perceived by state regulators to increase transmission costs and rates without increasing the value of, or benefits expected to be produced by, a project. In such cases, the potential for the Commission's incentive policy to increase rates without producing commensurate benefits is a barrier to state certification of the project, and therefore to the construction of new transmission facilities.

> Q4. How can the Commission's rate incentives policies balance the need for regulatory certainty with the changing investment climate over time? Are there metrics the Commission should monitor to achieve this balance, and if so, what are they? Are there other factors that change over time that the Commission should consider in evaluating incentives applications? Should the Commission consider these changes over time on a generic or case-by-case basis?[7]

In order to balance the need for regulatory certainty with the changing investment climate over time, the Commission should take into account the state of capital markets related to utility investment at the time of the initial application and each periodic re-evaluation. Metrics of scarcity of financial capital should be chosen from publicly available information and monitored by Commission staff. This will provide background information that will allow the Commission to evaluate individual proposals for incentives, on a case-by-case basis, based on an argument for the need of increased capital. However, the financial positions of individual developers cannot be ignored. The Commission needs to take evidence on a case-by-case basis of the applicant's need for incentives to attract the capital needed. For example, ROE should be established through discounted cash flow ("DCF") analysis using comparable companies that reflect the applicant's financial condition. Once granted, a company's continued need for incentive rates

[7] NOI, at P 15.

should be periodically revisited by the Commission to account for changing circumstances in the underlying economy and the specific circumstances of the transmission owning company.

Q5. Should specific rate incentives be tailored to address specific goals set forth by Congress in section 219?[8]

The purpose of an incentive is to accomplish a desired goal. Section 219 requires the Commission to establish a rule on incentive rate treatments for the purpose of benefiting consumers by ensuring reliability and reducing transmission congestion.[9] This is the goal set forth by Congress in section 219—benefiting consumers. Rate incentive policies that are not tailored to achieve that goal should not be considered by the Commission.

Q6. Are there other factors or considerations which the Commission should consider as part of its transmission incentive policies, in order to be consistent with the goals of section 219?[10]

The stated goal of section 219 is for the Commission to establish incentive rate policies for the transmission of electric energy in interstate commerce by public utilities for the purpose of "benefitting consumers by ensuring reliability and reducing the cost of delivered power by reducing transmission congestion". To comply with this, the Commission should; (1) require a net-benefits test for developers seeking incentives for projects proposed to improve economic efficiency; and (2) not provide incentives for reliability projects except in the narrow circumstance where the developer of a transmission project that is required to maintain established reliability standards faces demonstrated financial barriers to project completion.

[8] NOI, at P 15.
[9] Section 219 of the Federal Power Act at 16 U.S.C. 824s(a). (underlining added)
[10] NOI, at P 15.

With respect to requiring a net-benefits test for developers seeking incentives for projects proposed to improve economic efficiency, the OMS clarifies that these projects may span multiple states and carry a substantial price tag. However, it is not enough for the Commission to grant incentives on the simple assumption that these types of projects will reduce the aggregate cost of delivered power. Furthermore, the reduced cost of delivered power, in and of itself, does not ensure that consumers benefit, even in the aggregate. This is because, in the aggregate, consumers only benefit when the reduction in delivered power costs is greater than the cost of the transmission investment. It would not be rational to say that consumers benefit because the total cost of delivered power decreased by $5 million over the life of the project when the total cost of constructing that transmission project is $100 million. As such, the Commission needs to develop and implement a meaningful net-benefits test to ensure that, in the aggregate, consumers would benefit from a transmission project that receives incentives pursuant to section 219 of the FPA. In this regard, it is important for the Commission to include not only the Engineering and Construction costs in such net-benefit test, but also to include the rate of return being requested, and a calculation of the rates that ultimate beneficiaries will have to pay.

With respect to reliability projects, careful attention must be paid to the words that Congress chose to use in section 219. Section 219(a) uses the words "ensuring reliability." The section does **not** say "improving reliability" or "enhancing reliability." Reliability is "ensured" when the system is designed, constructed, and maintained to satisfy the reliability standards established by NERC, the regional reliability entities, and other applicable reliability standard-setting bodies. Therefore, section 219 is envisioning the possible granting of rate incentives for transmission projects that are needed to ensure reliability by enabling the network system to

continue to meet established reliability standards. Section 219 does **not** encompass rate incentives for a transmission project that is not needed to maintain established reliability standards, but may have the effect of improving the reliability of the transmission network. Nearly any loop that is added to a network would enhance the reliability of the network. However, if the additional network reliability is not needed to maintain established reliability standards, it would not be eligible for rate incentives under section 219(a). Perhaps Congress's rationale is that such projects may provide very little incremental benefit for electricity consumers.

In the RTO context, MISO membership carries an obligation to exercise best efforts to construct facilities that are needed to maintain established reliability standards.[11] Accordingly, the Commission should generally not grant incentives for such projects, unless there are demonstrated financial barriers for the assigned developers of such projects.

The Commission must also acknowledge and address the critical connection between incentive rates and regional transmission cost allocation in situations where the costs of new transmission facilities are shared between states. In the traditional regulatory model, the costs of a new transmission facility were borne by the ratepayers in the state in which the facility was to be physically located, with that state usually having decisional authority over the project in the form of required siting and certification approvals. If the state found that the costs of the facilities to its ratepayers (including any incentive rate costs) would exceed the expected benefits of the project, the state could decline to issue a certificate of convenience and necessity. If incentive rates of return raised costs above levels the state deemed reasonable, the state could avoid paying those costs by not

[11] This issue is discussed in more detail in Q10.

granting the certificate. Therefore, the state in which the facilities were to be located and paid for had leverage over what projects would be approved for siting and construction.

When the RTO planning process assesses new transmission facilities under a process that shares costs across multiple states, this useful check breaks down. In this case, as a state in which proposed facilities are to be physically located exercises its siting and certification authority, it would be reasonable to take into account only the facilities costs that will be allocated to ratepayers in its state. The state would reasonably grant the certificate if the expected benefits from a project exceeds the costs that will be allocated its ratepayers and ignore the costs that will be allocated to other states. With the exception of filing a section 206 complaint case, the other states in which the facilities will not be physically located, but to which costs will be allocated, typically have no say in this matter.

Therefore, regional cost sharing of transmission project costs creates a new problem and concern with FERC's incentive rate policy (and with the pass-through into retail rates of these costs). The remedy for this problem lies in a stronger role for states in the regional planning process that would regionalize the decision-making responsibility for projects where project costs are allocated among states.

Q7. Have the incentives granted to transmission projects had an impact on consumer rates and service, including impacts related to reliability and the reduction of congestion?[12]

No comment. The response to Q1/Q2 is related to this Q7.

Q8. Have the incentives granted to transmission projects had an impact on investment patterns in the electricity industry? Do the incentives

[12] NOI, at P 15.

impact the allocation of investment capital among transmission, generation and distribution facilities?[13]

The OMS is not able to provide a definitive answer as to the impact that the Commission's incentive policy has had on investment patterns in the electric industry. Indeed, there are a myriad of other legislative and regulatory initiatives which also influence the allocation of investment capital among transmission, generation and distribution facilities. For example, state renewable energy standards will have an enormous impact on investments made in wind generation and the transmission needed to deliver that generation.

However, given that allowed rates of return established by state regulators for distribution assets are generally lower than the rates of return allowed by the Commission for transmission assets (including rate incentives), it stands to reason that the tendency of integrated companies would be to allocate more capital to transmission and less to distribution than otherwise would have been the case absent the transmission rate incentives.

Q9. How should the Commission best balance the promotion of transmission investment with the assurance of just and reasonable rates?[14]

First, Congress's directive in section 219 is not to promote transmission without conditions; rather, the objective of section 219 is "benefitting consumers by ensuring reliability and reducing the cost of delivered power by reducing transmission congestion".

In response to Q6, the OMS has pointed out the need for a net-benefits test for transmission projects designed to improve economic efficiency. The OMS acknowledges the Commission's flexibility to consider non-cost factors in its rate determinations, but also believes that benefit/cost analyses can be a very important tool in developing rates that are just and

[13] NOI, at P 15.
[14] NOI, at P 15.

reasonable since this type of analysis assists in ensuring that costs are not only just and reasonable, but commensurate with the benefits that are received by electricity consumers (at least in the aggregate).

In addition, the Commission should ensure that each RTO tariff includes criteria for evaluating the cost effectiveness of reliability projects (meeting the established reliability standard at lowest cost).

Further, distinguishing between the financial barriers to project development and regulatory/environmental/engineering uncertainty barriers would permit the Commission to tailor any incentives to best address the challenges of the proposed transmission development while complying with section 219. Financial barriers to project development are those related to obtaining the capital necessary to build the transmission project. These barriers arise because of capital scarcity that may result from tight capital markets or from capital demands coming from other utility related investments that are needed within the same time frame, such as environmental upgrades or replacements to existing power plants required to meet new environmental standards. Regulatory/environmental/engineering uncertainties relate to areas that are unknown in the developmental stage of a transmission project and can drive up the estimated cost of a project, such as construction costs related to the detailed routing of new transmission lines and placement or upgrades of transmission substations. While these unknowns can result in the cancellation of a project, (e.g., if a project's costs increase as these unknowns are resolved to the point where expected costs exceed expected benefits), good planning should allow the determination of a cost cap at the early developmental stage along with the likelihood of project cancellation.

In order to ensure just and reasonable rates, the Commission needs to adopt procedures for ensuring cost and schedule containment for all reliability and economic efficiency projects seeking rate incentives. The OMS recommends the following two-step process for this purpose. The first step is to determine whether the developer of a transmission project is in need of transmission rate incentives due to financial barriers to project development such as capital scarcity. At this stage, it is important to distinguish between financial barriers to project development and regulatory/environmental/engineering uncertainties which require additional time to resolve, and can therefore be better determined at a later time in the second step.

i. The First Step: Financial Barriers to Project Development

In this first step, the Commission must require the applicant to demonstrate that its proposed project either ensures reliability (i.e., is needed to maintain established reliability standards) or reduces the cost of delivered power by reducing transmission congestion (i.e., is an economic efficiency project) as required by section 219. The OMS understands that projects driven by reliability requirements may provide some economic benefit, but whether or not such a project provides benefits in excess of costs is not at issue. Instead, such projects are needed to maintain reliability standards and should be designed to maintain those requirements in the most cost-effective manner. If a project designed to maintain reliability standards is not least cost, it must provide incremental economic benefits in excess of incremental costs above the least cost design. In this case, reliability projects that are not least cost must provide evidence that they are cost-beneficial in comparison to the least-cost design.

Any incentives granted by the Commission in this first step should be designed to overcome just the issue of capital scarcity. The Commission's evaluation of these step one filings would primarily focus on financial needs and non-ROE incentives required to meet those

needs. At this point, there should be no incentive ROE awarded for the risks related to regulatory/environmental/engineering uncertainties. Rather, in this step, ROEs should be determined through a proper DCF analysis that focuses on the financial position of the applicant and the state of capital markets.

ii. The Second Step: Performance-Based Incentives

The second step should occur after an entity seeking further incentives has developed both a definitive cost estimate and construction schedule necessary for completion of the project. Any entity that requests and is granted incentives under the first step, must submit a definitive cost estimate and construction schedule. Entities that don't need incentives to address capital scarcity can still submit their projects for performance-based incentives under the second step.

In this second step, the project developer will submit to the Commission its definitive cost estimate and schedule for implementation. Definitive cost estimates would typically include more concrete cost estimates and other project-specific information such as line routes, engineering studies and, where required, state determination of the routes for the transmission project. Assembling this type of information may take a year or longer after the initial request for incentives in step 1. For projects requiring a cost-benefit test, such projects must continue to prove to be cost-beneficial. For all projects, there should be a showing that the investment is cost-effective in meeting the purpose for which the project was initially approved. This will require detailed elements for the cost estimate, and a determination that these estimates are not out of line with industry experience.

After the applicant files the definitive cost estimate and construction schedule, the Commission would determine a framework of incentives and penalties associated with: (1)

incentives earned for being below the cost estimate or completing the project before scheduled completion date; and (2) incentives taken away for exceeding the cost estimate or completion of the project after the scheduled completion date.[15] For example, these schedules could give increasing/decreasing rates of return for lower/higher costs and implementation times. More details are included in answer to Q30.

While the incentives will allow the Commission to promote transmission investment, this two-step process provides the Commission with the necessary policies for cost and schedule containment for all projects to ensure that costs are not only just and reasonable, but commensurate with the benefits that are received (at least in the aggregate).

B. Section 219(a) Statutory Threshold

Q10. Do the rebuttable presumptions established in Order No. 679 serve as appropriate bases for satisfying the statutory threshold for section 219(a)?[16]

No. The Commission should discontinue use of the rebuttable presumption technique in transmission incentive cases.

The Commission has established rebuttable presumptions that a proposed transmission project satisfies the section 219(a) statutory threshold (i.e., that the project will either ensure reliability or reduce the cost of delivered power by reducing transmission congestion) if such project: (i) results from a Commission-approved fair and open regional planning process that considers and evaluates a project for reliability and/or congestion; or (ii) has received

[15] Such incentives and penalties have effectively been used for interstate highway upgrades. For example, the upgrade of Interstate 64, which is a main artery from the west suburbs of St. Louis, Missouri to the downtown area, used such incentives, and the project was completed ahead of schedule. The schedule was critical, as this major artery was shut down during the two-year construction period, placing traffic congestion on other routes downtown to St. Louis city.

[16] NOI, at P 17.

construction approval from an appropriate state commission or state siting authority that takes reliability and/or congestion into account.[17]

The OMS recommends that the Commission discontinue its use of the rebuttable presumption approach in its incentive rate policy. Such an approach is inconsistent with the way in which section 205 filings are normally processed, and inappropriately places the burden of proof on stakeholders and protestors rather than on incentive rate applicants. In addition, even if a project satisfies one of the rebuttable presumptions, it does not necessarily mean that the project can be presumed to either ensure reliability or reduce the cost of delivered power by reducing transmission congestion. RTO regional planning processes pursue numerous objectives other than just these two (for example, public policy initiatives) and state commission siting cases are not necessarily focused on regional impacts. So, while satisfying the rebuttable presumptions should be a necessary condition for an applicant to charge and collect incentive transmission rates, it is not sufficient in and of itself for the Commission to presume that an applicant's project satisfies the section 219(a) threshold criteria.

In addition, the Commission's current practice compounds the problems associated with the Commission's reliance on rebuttable presumptions because the Commission has exhibited a willingness to approve incentive rate applications conditioned on the applicant **subsequently** satisfying one of the rebuttable presumptions. So, the Commission's practice has frequently been to grant applicants' incentive rate requests even though the applicant has not satisfied either of the rebuttable presumptions at the time of its application and has not made an independent showing that the section 219(a) threshold criteria (i.e., that the project will either ensure reliability or reduce the cost of delivered power by reducing transmission congestion) have been

[17] NOI, at P 16.

met. As a result, through the rebuttable presumption technique and the Commission's practice of conditionally approving incentive rate applications based on subsequent satisfaction of one of the rebuttable presumptions, the Commission has avoided the rigorous evaluation of incentive rate applications that the public interest demands.

The OMS also notes the Commission's final rule on transmission planning and cost allocation, which requires every public utility to participate in a regional transmission planning process.[18] Given that every project that receives regional cost allocation will now meet the standard of being the product of a regional planning process, the Commission's rebuttable presumption test becomes hollow once Order 1000 is implemented.

Rather than continue with the rebuttable presumption technique, the Commission should instead issue a rule listing the standards or conditions that a prospective applicant will be required to meet. The standards and conditions would be different for each of the two threshold criteria in section 219(a), namely ensuring reliability or reducing the cost of delivered power by reducing transmission congestion. Once these standards have been developed and put in place, the Commission will have better control over its own processes (i.e., will not be holding itself hostage to another entity's actions and decisions, be it the regional planning organization or the state siting authority) and will be better able to independently assess whether an applicant has demonstrated satisfaction of one of the two threshold conditions set forth in section 219(a).

[18] *Transmission Planning and Cost Allocation by Transmission Owning and Operating Public Utilities*, 136 FERC ¶ 61,051 (2011), at P 146.

Q11. Are there other criteria that the Commission should adopt as additional rebuttable presumptions for satisfying the statutory threshold for section 219(a)?[19]

No. As noted above, the rebuttable presumption approach is flawed. The OMS recommends that the Commission discontinue use of the rebuttable presumption technique in its review and assessment of transmission incentive rate applications. Rather, the Commission should specify in a rule the standards or conditions that a prospective applicant will be required to meet in order to demonstrate satisfaction of the section 219(a) threshold criteria (i.e., that the project will either ensure reliability or reduce the cost of delivered power by reducing transmission congestion).

Q12. What types of information, data, or studies should the Commission consider in evaluating whether an applicant has made an independent showing that satisfies section 219(a)?[20]

Section 219(a) requires that the incentive-based rate treatments provided to public utilities must be for the purpose of benefitting consumers by ensuring reliability or reducing the cost of delivered power by reducing transmission congestion. As explained above, the OMS recommends elimination of the rebuttable presumption approach for making these threshold showings. If such presumptions are eliminated, then all applications for incentive rate treatment would be based on an independent demonstration by the applicant that the threshold is met, including a showing that electric consumers will be benefited from the proposed project and by the grant of incentives for such project.

With respect to the showing for ensuring reliability, the project must be designed to address a violation of an established reliability standard of an official reliability standards

[19] NOI, at P 17.
[20] NOI, at P 17.

organization such as NERC or a regional reliability entity. In MISO, these types of projects are referred to as baseline reliability projects.[21]

With respect to evaluating projects designed to reduce transmission congestion, the Commission should require a study of the effect the project has on locational marginal prices and adjusted production costs. Such analysis should be conducted for various different reasonable future scenarios. This type of study would allow the Commission to assess whether the proposed project would be beneficial to consumers by reducing the cost of delivered power and to what degree it is beneficial and which sets of customers would be impacted.

Q13. Would it assist applicants if the Commission established a procedure that applicants may follow to make such an independent showing? If so, what should be the characteristics of that procedure?[22]

Yes. The OMS is recommending that the Commission eliminate its reliance on rebuttable assumptions. Therefore, each incentive rate application would need to make an independent showing that it meets the threshold requirements of section 219(a) in order to be eligible to be considered for transmission rate incentive authority. Such a showing would include economic and engineering studies as described in the response to Q12.

Q14. In some cases, when an applicant has sought incentives, the Commission has conditionally approved the request subject to the project receiving approval in a regional transmission planning process or state siting process.[23] Intervenors in various rate proceedings have raised concerns that a project scope may change in the planning and siting process. In light of this, how should the Commission balance the

[21] Because the construction of baseline reliability projects in MISO is a contractual obligation of transmission-owner membership, such projects should not normally be granted transmission rate incentives, except in cases where the applicant can show extraordinary financial barriers associated with undertaking the contractually-obligated project.

[22] NOI, at P 17.

[23] As discussed above, these processes are related to satisfying the rebuttable presumptions set forth in Order No. 679.

> value of and need for the requested incentives in promoting project development and financing with the potential uncertainty surrounding project scope?[24]

The OMS recommends that the Commission require transmission projects to be included in a regional transmission expansion plan in order to be eligible for ROE performance incentives under Step 2 of the OMS's proposal, or to charge and collect incentive transmission rates. In reforming its incentive rate policy, the Commission should not make changes that would undermine the importance of participating in the regional transmission planning process.

The Commission should not approve incentive requests conditioned on a project subsequently being included in a regional transmission expansion plan. As noted in the NOI, the scope of a project can significantly change in going through the regional planning process and the project that is ultimately approved may be significantly different than the project upon which the Commission conditionally granted incentives.[25] Since the Commission needs to evaluate the total package of incentives,[26] a change in the scope of the project can impact that evaluation and a project may be granted incentives that are either too generous or not adequate for the project. Granting incentives on a conditional basis may also result in unintended consequences. For instance, a scenario may occur where several potential developers are proposing competing projects in the regional planning processes. If all are granted transmission incentives on a conditional basis, but only one project is ultimately placed into the regional expansion plan, the other project developers may feel compelled to petition the Commission for recovery of pre-commercial expenses and abandonment costs. Such a process will unnecessarily consume the resources of both the Commission and affected parties. The granting of incentives on a

[24] NOI, at P 17.
[25] NOI, at P 17.
[26] Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 21.

conditional basis may also provide developers with an opportunity to use someone else's money to pursue a project well after it appears that the project will not qualify to be entered into the regional expansion plan. Such a policy is problematic, as it provides developers with the opportunity to "throw good money after bad".

Consequently, the Commission should not approve incentive rate applications conditioned on subsequent achievement of milestones such as inclusion of a project in the regional transmission expansion plan. Rather, the Commission should require each applicant for incentive rate treatment to independently demonstrate satisfaction of the threshold criteria in section 219(a) (i.e., that the project will either ensure reliability or reduce the cost of delivered power by reducing transmission congestion). The OMS recommends that, in order to be eligible for ROE performance incentives under Step 2 of the OMS's proposal, or to charge and collect incentive transmission rates, applicants must demonstrate that their project has been selected in a regional plan. In conjunction with the ROE analysis conducted in step 2, the Commission may re-visit incentives granted in step 1 if circumstances for which the granting of those incentives was based has materially changed.

C. Additional Goals of Section 219

Q15. Pursuant to section 219(b)(1), what steps could the Commission take to "promote reliable and economically efficient transmission and generation of electricity by promoting capital investment in the enlargement, improvement, maintenance, and operation of all facilities for the transmission of electric energy in interstate commerce"?[27]

No comment.

[27] NOI, at P 20.

Q16. How would these steps affect other aspects of the Commission's rate-making policy?[28]

No comment.

Q17. Pursuant to section 219(b)(3), what steps could the Commission take to "increase the capacity and efficiency of existing transmission facilities and improve the operation of the facilities"?

No comment.

Q18. As indicated above, applicants must show that their project meets the threshold under section 219(a). What showing should the Commission require to support a request for incentives under section 219(b)(1) and (b)(3)?[29]

No comment.

D. Order No. 679 Nexus Test

Q19. Does the focus of the nexus test on the risks and challenges of a given transmission project remain appropriate for the purpose of justifying incentives? Is that focus more appropriate for some incentives than others? What other factors should the Commission consider?[30]

The Commission describes the nexus test as follows: "that the incentives being requested are 'rationally tailored to the risks and challenges faced' by a project."[31] Focusing on risks and challenges faced by a developer for a particular project is not unreasonable. The OMS encourages the Commission to focus, in particular, on the financial barriers (specifically, capital scarcity) that an applicant faces. As explained in response to Q36, it does not make sense for the Commission to grant incentives such as ROE incentive adders to developers facing

[28] NOI, at P 20.
[29] NOI, at P 20.
[30] NOI, at P 25.
[31] NOI, at P 21 quoting Order 679, at P 26.

regulatory, siting, or environmental challenges. Those kinds of challenges cannot be cured by granting ROE adders.

Experience with the Commission's transmission rate incentive policy over the years has demonstrated that the nexus test is not sufficiently rigorous and is prone to subjectivity. The "rationally tailored" part of the nexus test needs to be objectively defined. Applicants for transmission incentives should be required to identify and explain the particular risks and challenges faced, and the link between each requested incentive (and the interactions between the requested incentives) and the particular risks and challenges faced. The effect of the requested incentive on the asserted barrier must be clearly described. The tailoring of the incentive to the asserted risk or challenge must be specific.

The two-step process described elsewhere in these comments provides the framework for making the required showings.

> Q20. Would focusing on project characteristic or effects be a more effective means than focusing on a project's risks and challenges as the basis for granting incentives? What characteristics or effects would be appropriate for the Commission to consider for that purpose, consistent with section 219?[32]

Yes. In particular, when related to "risks and challenges" other than financial barriers to project development as described in step 1 of the OMS's proposed two-step process. Focusing on a project's effects in step 2 of the OMS proposed two-step process, instead of risks and challenges, would provide the Commission with a more effective means of achieving the goals of section 219. By focusing on aggregate benefits delivered by a transmission project and cost

[32] NOI, at P 25.

containment, developers would be motivated to look for those projects that would deliver the most value to consumers.

With respect to the estimation of benefits, RTOs have methods in place for estimating benefits such as production cost savings, LMP reduction metrics, and savings in losses. Other benefit metrics are being developed by RTOs that could also be used to measure benefits. However, it is critical that sensitivity studies be performed to determine a reasonable range of benefits coming from a specific project requesting incentives.

The OMS recommends that the Commission require an RTO's tariff to describe the methods by which the RTO will ensure that each project designed to address an identified reliability issue be cost effective and each project designed to increase economic efficiency by reducing transmission congestion be cost beneficial.

> Q21. What risks and challenges are transmission developers facing today? Have such risks and challenges evolved since the issuance of Order No. 679, and if so how?[33]
>
> No comment.
>
> Q22. Is the distinction between a routine and non-routine project in analyzing "risks and challenges" useful in providing guidance to the industry on how to apply the nexus test? Does this distinction appropriately differentiate between the level of difficulty in constructing various transmission projects?[34]

Any non-performance based transmission rate incentives should be limited to unusual circumstances and special projects. In administering a transmission rate incentive program, it would help for the Commission to develop a list of project and applicant types for which the

[33] NOI, at P 25.
[34] NOI, at P 25.

Commission would not normally grant transmission incentives.[35] In this sense, it would help for the Commission to publish a list of "routine" project types. Typically, there would not be a need for the Commission to provide incentives to routine projects.

Examples of routine projects might include those that are located within one transmission owner's zone, are required to be developed under contractual or similar obligations, are driven by reliability requirements and/or do not display any use of advanced technologies. Such projects either do not warrant incentives or any incentives that are granted should not be through ROE incentive adders. All told, appropriate compensation for routine projects should be reflected in the standard Commission treatments and ROE.

On the other hand, projects that span the territories of multiple transmission owners, or even span multiple regions which are not being built under contractual obligations and/or display the use of advanced technologies, may have a claim for being considered as non-routine. Such projects are likely to have a higher level of risk relative to routine projects and may well merit being granted a higher level of incentive, particularly if the projects also display considerable benefits relative to their costs. However, a project should not simply be granted incentive treatment because it is considered to be non-routine. Rather, only non-routine reliability projects that are shown to be cost effective and that face extraordinary financial barriers and non-routine economic efficiency projects with expected benefits in excess of cost should be considered for incentive treatment.

Q23. What types of criteria should the Commission consider when evaluating the "scope of a project" or the "effect of a project," in determining whether a project is routine or non-routine? Should the

[35] If such a list is developed, it would be important to recognize that projects or applicants included in the list may still qualify for transmission incentives if they face genuine financial barriers to project development.

Commission establish bright line criteria, such that a project meeting those criteria is non-routine regardless of the applicant, or should this evaluation depend on the circumstances of the applicant, e.g. the estimated cost of the project relative to the applicant's transmission rate base?[36]

As explained in response to Q22, the Commission's administration of the incentive rate program may be eased by development of a routine project list or similar such list of project types or applicant types that would not normally qualify for incentives. Crafting a non-routine project list is likely to be more difficult because a project that is non-routine for one company may be routine for another. Because of such circumstances, the Commission should expect to be faced with requests for exceptions if it does choose to develop a list of non-routine project types.

Q24. Are there aspects of the Commission's accounting and ratemaking policies, including the use of formula rates, that reduce or increase the risks and challenges of a transmission project? If so, how should the Commission take into account the effect of its accounting and ratemaking policies in evaluating incentive applications?[37]

The use of formula rates, including those that permit forward-looking costs to be incorporated into the formula rate reduce the risk associated with recovery of costs or timing of recovery of cost for a transmission project. Therefore, the Commission should consider the risk reducing features of formula rates and other accounting techniques when considering transmission incentive requests.

Q25. In Order No. 679-A, the Commission stated that "[i]n general, we do not consider that contractual commitments or mandatory projects, such as section 215 reliability projects, disqualify a request for incentive-based rate treatment. Provided applicants are able to demonstrate they meet the requirements of section 219, including establishing the required nexus between the requested incentive and the investment, they may qualify for incentive-based rate treatments. A

[36] NOI, at P 25.
[37] NOI, at P 25.

> prior contractual commitment or statute may have a bearing on our nexus evaluation of individual applications.'' Is the existence of a contractual commitment to build a relevant factor in considering applications for rate incentives?[38]

Yes, contractual commitments are a relevant factor in assessing rate incentive applications. An incentive is aimed at motivating a specific type of behavior. A contractual commitment requires a specific behavior. In light of this, the existence of a contractual commitment should be considered a relevant factor in the incentive rate applications. However, while a contractual obligation will likely reduce the need for incentives, it still may be beneficial to grant incentives to projects that are the result of a contractual obligation. This is true because, when properly designed, incentives can motivate developers to research and formulate plans for beneficial projects that may not be discovered through the RTO transmission planning processes. This is especially true of the development of economic efficiency projects relative to reliability projects. Reliability projects are developed through the application of operational and planning protocols, which are standardized. They are also planned under regulatory compulsion and penalties. On the other hand, economic projects are not required because of operational necessity, but rather are the product of professional acumen and therefore could still be motivated by certain incentives - even when subsequent planning results in a contractual commitment to build. In either case, both incentives for cost and schedule containment could be applied.

When a contractual commitment to build transmission facilities exists, one cannot help but question the premise that a nexus exists for transmission rate incentives, outside of those related to capital scarcity and cost and schedule containment. Under those circumstances,

[38] NOI, at P 25 (footnote omitted).

granting incentives simply leads to increased rates for transmission customers for facilities that most likely would have been built without the incentives. The resulting rate, when such incentives are provided to transmission developers already under an obligation to construct facilities, does not appear to be a rate where the benefits received by transmission customers are commensurate with the additional costs imposed on them by the incentives granted by the Commission.

To the extent any nexus can be drawn between transmission rate incentives and the building of required facilities under section 215, applicants for the incentives should have to demonstrate that incentives allow the project to be completed sooner than it would have been otherwise. An earlier completion date could yield increased benefits to ratepayers and thereby justify some increased costs for transmission customers.

Q26. The Commission has encouraged the joint ownership of transmission facilities but declined in Order No. 679 to make it a requirement for receiving incentives. Does this approach adequately account for the benefits of joint ownership? Are there other approaches to providing incentives that encourage joint ownership of transmission facilities?

No comment.

E. Interrelationship of Incentives

Q27. Are there specific criteria the Commission should use in evaluating whether and how to adjust certain incentives to account for the impacts of other incentives?[39]

No comment.

Q28. Do certain incentives sufficiently mitigate the risks and challenges of a transmission project so as to obviate the need for granting other incentives, or warrant adjustment in the level of those incentives? For example, should granting 100 percent CWIP and recovery of

[39] NOI, at P 26.

abandoned plant affect the evaluation of a request for an incentive ROE adder based on a project's risks and challenges?[40]

Rate incentives cannot reduce the regulatory/environmental/engineering risk associated with a transmission project. Rather, they can either shift the risk to another party, such as CWIP or recovery of abandoned plant, or they are meant to compensate the developer for bearing the risk, as does an increased ROE. Given that the determination of an appropriate ROE is to compensate a developer for bearing a certain amount of risk, any request for incentive ROE should be evaluated in light of the other incentives that were awarded a project developer and the associated risk which was shifted to other parties. The OMS recommends that the Commission employ its standard DCF approach to establish the ROE for an applicant in the first step of the proposed two-step process. Incentive ROE would not be granted in this first step in any case. Other incentives authorized in the Commission's Order 679 should be tailored to the specific financial barriers demonstrated by an applicant proposing a particular project. The need for incentive ROE may be considered in the second step but it is expected that the Commission would only infrequently find such pleadings persuasive enough to grant an ROE incentive because, by the time a project reaches this second step, most non-financial barriers will have been worked out and most financial barriers will have been addressed by measures adopted in the first step.[41]

F. The Role of Cost Estimates

Q29. Should the Commission limit the application of incentives to the cost estimate utilized for including or retaining the project in the plan submitted through the regional planning process? If so, which

[40] NOI, at P 26.

[41] In these Comments, the OMS is distinguishing between an incentive ROE, a performance-based ROE bonus/penalty, and an ROE adder to incent transmission-owning company behavior such as joining an RTO or creating a Transco.

> incentives should be applied to the cost estimate, and which should be applied to all prudently incurred costs?[42]

Many of the incentives available under Order No. 679, such as ROE adders, have been allowed to apply to the actual costs of the projects rather than estimated cost of the project that is provided by the sponsors of the project. Basing rate incentives, particularly ROE adders, on a project's actual costs does not provide transmission project developers with an incentive to contain costs and more likely gives them an incentive to drive up costs, since they will effectively earn a bonus return for doing so.

Experience has shown that developmental cost estimates used in the regional planning process are not definitive cost estimates and have been off by as much as 50 percent when compared to a project's actual costs. Assuming good faith on the part of project cost estimators, this difference may be primarily related to cost elements that cannot be known until detailed engineering studies have been performed to specifically determine line routes.

In order to counteract this critical problem of project cost over-runs, the first step of the OMS's proposed two-step process can be implemented before a definitive cost estimate is available. In the first step, the Commission will evaluate an applicant's request for transmission rate incentives, other than ROE adders. In this step, the Commission should also require each applicant to provide a cost cap on capital that will be needed for the proposed project. Incentives to address identified financial barriers in the first step would only be applied up to the allowed cost cap. The second step would be initiated only after a definitive cost estimate is submitted, and any additional bonuses and penalties granted to the applicant with regard to ROE would be based on performance relative to the definitive cost estimate and scheduled time for completion.

[42] NOI, at P 28.

Q30. How could such an approach be implemented? Would this approach work in all regions of the country? What processes for developing, evaluating, and updating cost estimates must be in place within regional transmission planning processes to facilitate such an approach?[43]

It may take an applicant a year or longer to move from the initial incentive request in the first step to the point where a definitive cost estimate is filed in the second step, where performance-based incentives for cost containment could be implemented. This timing is primarily a matter of having to narrow the unknowns that exist prior to performing detailed engineering studies and obtaining regulatory approval for specific line routes.

With respect to the Commission's awarding bonuses and imposing penalties on an applicant with regard to ROE in the second step, the OMS recommends that they be based on actual performance relative to the definitive cost estimate and scheduled time for project completion. For example the Commission could implement a narrow dead band limit of +10 percent cost increase in actual cost incurred over the definitive estimate before penalties. In this way, project investors can decide when their estimates have addressed unknowns sufficiently to meet this +10 percent upper bound on cost increases.

Where actual costs come in below the estimate, any ROE bonuses should not be so large as to wipe out the project cost savings. For example, if actual costs come in at 5 percent below the definitive estimate, the non-incentive ROE times the 5 percent savings would put an upper bound on what can be added to the ROE that is applied to the entire cost of the project. In short, the ROE should be set at a level so that any savings are shared equally between the developer and the rate payers. While the authorization decision for eligibility for an ROE bonus would be made by the Commission when the applicant provides the definitive cost estimate in the second

[43] NOI, at P 28.

step, the actual earning of the authorized bonus by the developer would be awarded only upon project completion (when final project cost is known and project completion is final).

Q31. If a change in cost estimate is not due to the failure to contain costs but instead reflects the real cost in building the proposed transmission line, should the Commission take that consideration into account, and if so, how?[44]

The OMS's proposed two-step process will largely address this issue. An initial project cost estimate will be provided by an applicant in the first step along with a cost cap on capital that is expected to be needed for the project. Any incentives granted in the first step would only apply up to this established cost cap. In the second step, the applicant would provide a definitive cost estimate. Any ROE bonuses or penalties authorized in the second step will be based on the relationship between actual finalized project costs and the definitive cost estimate (allowing for a dead-band on cost increases).

With respect to Q31, the OMS assumes that the phrase "real cost in building" means a change in construction cost variables that are still unknown at the time the project developer submits a definitive cost estimate to initiate the second step. The Commission could deal with this unusual circumstance by allowing changes in the definitive cost estimate subsequent to making its findings in the second step. By having the details of the definitive cost estimate in evidence and a determination that this estimate is consistent with industry experience, the Commission could review the specific changes that have occurred. Any filings to change the definitive cost estimate should be limited to those that exceed the 10 percent dead band established in the original findings. In most cases, however, the developer should expect to be

[44] NOI, at P 28.

held to the definitive cost estimate established by the Commission when the developer makes its filing in the second step.

Q32. Should new reporting requirements be in place to allow the Commission to audit compliance with a requirement to limit incentives to some project cost estimate?[45]

If the Commission chooses not to implement the OMS's suggested two-step process, the Commission should require regular updates that indicate how well the project implementation is doing compared to the cost estimates used to approve the project. An implementation schedule that includes expected dates for completion of various parts of the project and associated costs could also be required so that the Commission will have a basis for filings that compare not only costs, but also schedule implementation. Information could relate to the cost over-runs by major project phases. Requirements could include an assessment of the reason for the cost over-runs as well as the lessons learned and a final net customer benefit analysis based on the final project costs. However, it should be noted that imposing a filing/compliance requirement effectively increases the costs of a project.

If the Commission adopts the OMS's two-step cost containment approach, it would be prudent to have a developer file a limited number of update reports. The pre-specified penalty and strict review of cost over-runs should effectively discipline project managers.

G. Individual Incentives

Q33. The Commission has general ratemaking policies with respect to CWIP and recovery of abandoned plant costs, as discussed below. Pursuant to Order No. 679, incentives above and beyond those general ratemaking policies may be requested on a case-by-case basis. Would it be appropriate to remove these issues from the case-by-case analysis of incentive requests,

[45] NOI, at P 28.

in favor of exploring changes to the Commission's general ratemaking policies? What would be the impact on ratepayers of revising these ratemaking policies, rather than authorizing higher levels of CWIP or recovery of costs of abandoned plant on a case-by-case basis?[46]

The Commission should not incorporate the CWIP and abandoned plant incentives into its general ratemaking policy. Rather, it should retain these mechanisms as options to be employed in its section 219 rate incentives rule.

CWIP and recovery of abandoned plant costs are basically mechanisms to shift project risk from developers to ratepayers. Shifting the risk may result in lower financing costs for the developer and, therefore, lower rates for ratepayers. However, this beneficial result for ratepayers results only if the project is completed and is used and useful. If the project is not completed and is not used and useful, then ratepayers end up paying costs for nothing. The incentives application process constitutes a useful means to assess these cost/risk/rate trade-offs. Allowing 100 percent of CWIP in rate base and 100 percent recovery of project cost abandonment as part of the normal ratemaking process would unnecessarily pre-decide these cost/risk/rate trade-offs in a generic, rather than case-by-case basis.

Q34. The Commission stated in Order No. 679 that it had not established specific eligibility criteria or conditions for incentives because it would limit the Commission's flexibility with respect to its application of the Rule. The Commission is interested in receiving comments regarding whether the establishment of criteria for eligibility for particular incentives would enhance regulatory certainty and predictability and serve to further encourage appropriate investment in transmission infrastructure. Should the Commission establish specific criteria or conditions that applicants must meet in order to be eligible for these individual incentives?[47]

[46] NOI, at P 29.
[47] NOI, at P 29.

While the establishment of eligibility criteria for incentives would enhance regulatory certainty and predictability, the Commission must ensure that the criteria that it establishes are meaningful and not just a "check the box" requirement. If a proposed incentive case is not contested, then a minimum criterion could reduce excess incentives; but a required criterion set too low would void disputing need for incentive in a contested case.

Specific criteria for incentives for capital scarcity may be developed over time as the Commission gains experience with individual filings. However, for ROE incentives for cost containment, the OMS has already proposed eligibility criteria for economic projects. All projects need to provide evidence of being cost-effective.

H. Incentive ROE Adder for Project Risks and Challenges

Q35. What risks and challenges are appropriately addressed by the incentive ROE adder? Is it appropriate for the Commission to evaluate these risks and challenges on a project-by-project basis or on an aggregate basis for the applicant?[48]

As the OMS has explained elsewhere in these comments, non-routine project risks and challenges should be addressed through non-ROE incentives in the first step of its proposed two-step process. ROE for the applicant should be established in the first step using the Commission's normal DCF analysis mechanism. Incentive ROE adders should not be granted in the first step and would only be granted in the second step upon the showing of a change in need with respect to capital scarcity. Granting incentive ROE adders at any stage in the process to address non-financial barriers to project development does not make sense.

For applicants that can show a need in the second step for incentives due to capital scarcity, only risks and challenges that cannot be reduced through a non-ROE incentive or other

[48] NOI, at P 31.

project-tailored provisions should be considered for an incentive ROE adder. Since this is about capital scarcity being faced by the applicant, risks and challenges would seem to be primarily on an aggregated basis for the applicant. However, the specific project for which an incentive ROE adder is being requested may pose additional risks and challenges that the Commission should consider.

Q36. Are there other considerations that the Commission should focus on when awarding an incentive ROE adder?[49]

The Commission should generally use non-ROE incentives to address specific financial barriers faced by applicants and only apply ROE incentive adders in extraordinary cases where the applicant can identify a financial barrier not addressed by its normally allowed ROE and non-ROE incentives.

The levels granted by the Commission under its current policy (inclusive of incentive ROE adders) often provide developers with returns that are in excess of those granted by state commissions for distribution and generation assets. The Commission should study whether this differential significantly skews investment between these different business lines. Moreover, as in step 2 of the OMS's proposed two-step process, ROE adders should generally be performance-based.

In addition, given that the general financial environment in the United States has changed dramatically over the last few years, it may be in the public interest for the Commission to re-visit some of its past incentive cases to see if the ROE incentives that were granted are still appropriate for the current financial environment.

[49] NOI, at P 31.

Q37. Does the base ROE adequately compensate investors for the financial risk of the company, including risks associated with the particular transmission project for which incentives are sought?[50]

In theory, the base ROE adequately compensates investors for the financial risk borne by the company, including risks associated with routine transmission projects. As discussed in more detail below, a non-routine transmission project may or may not have higher risks for which incentives may be appropriate. To the extent that a non-ROE incentive which addresses the specific risks faced by the company is granted, no incentive ROE is necessary.

Q38. In determining the incentive ROE adder, and the requisite risks and challenges that support such an adder, should the Commission identify with specificity the types of risks and challenges that most warrant an incentive ROE?[51]

It may be appropriate for the Commission to distinguish between barriers in determining the type of incentives to use. Issues concerning capital scarcity should first be addressed with non-ROE incentives that reduce the risks to the developer caused by the financial barriers. If non-ROE incentives are not sufficient in reducing financial barriers, and the normal ROE does not adequately compensate for the risks, then the overall level of ROE could be increased through incentive adders. However, the OMS expects that to be a rare circumstance.

Specific types of incentives are best targeted to specific types of financial barriers. For example, CWIP recovery addresses cash flow issues. Regulatory barriers, on the other hand, may be best addressed by the use of the abandonment incentive. Distinguishing between the financial and regulatory barriers would permit the Commission to tailor the incentives to best

[50] NOI, at P 31.
[51] NOI, at P 31.

address the challenges faced by the developer for a specific proposed transmission project while reducing the impact upon ratepayers.

Q39. In determining the incentive ROE adder, should the Commission make a distinction between financial barriers to transmission development such as the ability to attract capital, and regulatory barriers, such as siting or environmental challenges? If so, how?[52]

Yes. In the two-step process proposed by the OMS in these comments, step one relates to having the Commission address financial barriers. Financial barriers relate to the overall financial environment combined with the financial position of the entity that is attempting to raise capital. If financial markets are tight, this will result in the supply of capital going to investors who have the highest probability of obtaining the highest rates of return with the lowest risk of downside losses. These types of financial barriers can be addressed through reducing the risk of loss and performing a correct analysis of the ROE needed to raise capital.

Step two in the OMS's recommendation relates to bonuses and penalties to induce project cost and schedule containment. Regulatory barriers related to siting or environmental concerns can result in higher costs for projects. However, if step two is taken subsequent to the siting of the transmission upgrade, then the definitive cost estimate should have significantly reduced if not eliminated these risks.

Q40. In determining the incentive ROE adder, how should the Commission balance the impact of other risk-reducing incentives (such as CWIP and abandoned plant recovery)?[53]

The determination of the appropriate level of ROE is company specific and inextricably tied to the level of risk associated with a project. In the first step of the OMS's two-step

[52] NOI, at P 31.
[53] NOI, at P 31.

proposal, when granting incentives that reduce risk for the developer, such as CWIP and abandoned plant, the Commission must incorporate the impact of those factors into its determination of the overall level of ROE to ensure rates are just and reasonable. Indeed, because those incentives lower the risk to transmission developers, higher ROE incentives may not be necessary or appropriate. The Commission should consider promoting non-ROE incentives first in conjunction with an ROE established through the normal DCF approach and then, after those are established, determine if a higher incentive ROE as the base from which performance ROE adders are calculated is really necessary in the second step. Finally, projects granted incentives that lower the developer's risks should not be granted incentive ROE adders that move the overall ROE beyond the midpoint of the zone of reasonableness in a DCF analysis. The normal ROE determination process properly takes into account financial market conditions and the financial condition of the applicant through comparison to companies with comparable corporate risk/return profiles.

Q41. Does regulatory assurance of cost recovery, either at the state or regional levels, mitigate the risks and challenges facing a transmission project? If so, how should the Commission give consideration to this mitigation in evaluating a request for incentive ROE adder based on a project's risks and challenges?[54]

Yes. Regulatory assurance of cost recovery at any level mitigates the downside risk of under recovery. Under such circumstances, no ROE adder would be needed beyond the standard ROE determined through a proper DCF analysis.

[54] NOI, at P 31.

I. Incentive ROE Adders for Transcos

Q42. Is it appropriate to promote voluntary formation of Transcos, as defined in Order No. 679, through an ROE adder? Would other incentives promote Transco formation more effectively?[55]

The impact of offering adders to Transcos, and defining Transco broadly as the Commission did in Order 679, is that it incents utility companies to spin off transmission into a separate transmission holding company simply to gain a higher ROE on their transmission investment. Then when a transmission upgrade is needed in the utility's service territory, it will pass that upgrade to its transmission affiliate without there being a competitive solicitation for that upgrade. While Order 1000 eliminates the right-of-first refusal, subject to specific exceptions, it is not clear at this point whether or not Order 1000 clearly prevents this type of behavior. The transmission affiliate has the benefit of the utility's financial position by being in the same holding company, and from a step one financial perspective may not need an ROE adder to attract capital. The result in this case is simply a higher cost to ratepayers without any justification outside of the Commission's policy "to promote voluntary formation of Transcos."

If the Commission believes there are benefits to promoting the voluntary formation of Transcos, any ROE adder should be limited strictly to stand-alone transmission companies that have no affiliation with a utility. In addition, the Commission should re-examine its presumption that having Transcos as compared to some other form of business structure for transmission facility ownership actually benefits electricity consumers. Conducting an actual study on this question would be useful because benefiting transmission consumers is the threshold requirement for incentives eligibility under section 219(a).

[55] NOI, at P 33.

Q43. Order No. 679 does not distinguish between Transcos that are independent of generation owning market participants and Transcos that are affiliated with such market participants. Would such a distinction be appropriate in terms of eligibility for, or the amount, of a Transco adder?[56]

Yes. See answer to question 42. The Commission should distinguish between Transcos that are independent of generation owning market participants and those that are not independent of those entities. As noted in the OMS comments in the original incentive rate rulemaking, there is a significant difference between Transcos that are affiliated with generation resources and those that are "stand-alone" transmission companies.[57] The presumption is that stand-alone Transco business structure is more likely to be beneficial to electricity consumers than the affiliated Transco business structure. However, it would be reasonable for the Commission to study this matter and adjust its transmission rate incentive policy accordingly,

Q44. Further, Order No. 679 did not distinguish between Transcos that result from divestiture of a vertically-integrated utility's existing transmission system and Transcos that are created for the purpose of developing a particular new transmission facility. Would such a distinction be appropriate in terms of eligibility for, or the amount of, a Transco adder?[58]

The OMS recommends that the Commission conduct a study on the benefits of various Transco business structures for electricity consumers for the purpose of administering section 219(a).

[56] NOI, at P 33.
[57] Docket No. RM06-4-000, Comments of the Organization of MISO States, at 14
[58] NOI, at P 33.

J. Incentive ROE Adders for Transmission Organizations (RTO/ISO)

Q45. Is it appropriate to offer a standard ROE adder for all utilities that join or remain members of an RTO/ISO?[59]

No. Granting a standard ROE adder for any particular action without regard to the particular circumstances faced by the company is not a reasonable policy. The OMS is not opposed to encouraging utilities to join or remain in an RTO. However, the encouragement should be tailored to the particular circumstances facing the company and not merely a standard ROE adder.

Q46. In the alternative, are there other incentives that the Commission should consider to encourage joining or remaining in an RTO/ISO?[60]

Yes. One of the largest missing components of RTOs in the Midwest is electric Cooperatives. An ROE adder is not an incentive for a not-for-profit Cooperative to join or remain in an RTO. There appear to be two major barriers for Cooperatives joining RTOs: (1) loss of pancaked transmission rate revenues; and (2) having their cost increased through the application of region-wide, postage stamp rates. These barriers would have to be overcome by benefits that the RTO can provide to the Cooperatives. Such benefits are most likely to be found through production cost savings in the energy and ancillary services markets.

The Commission may be able to offer incentives that are tailored to the particular barriers faced by different types of companies proposing to join RTOs. Using Cooperatives as an example, a form of rate adder during a transition period to compensate for lost transmission revenues could be considered.

[59] NOI, at P 35.
[60] NOI, at P 35.

In summary, granting a standard ROE adder to all companies that join an RTO is not the most effective way to encourage RTO participation. Tailoring an incentive to the particular circumstances and needs of different applicants would be more effective and more likely to produce benefits for electricity consumers.

Q47. Should the existing 50 basis point adder be increased to better encourage the formation and continuance of RTO/ISO arrangements?[61]

No. Indeed, the Commission should explore whether rescinding the standard 50 basis point adders that it has already granted or tailoring an incentive adder to the particular circumstances of existing RTO transmission owning members would benefit electricity consumers as required by section 219(a). As explained in the response to Q46, the Commission may be able to offer incentives that are tailored to the barriers faced by certain types of transmission owning companies seeking to join or remain in RTOs.

The OMS also notes that there are many non-incentive factors that encourage the formation and continuance of RTOs. For example, some states have placed statutory obligations on their utilities to participate in an RTO. Further, RTOs typically feature competitive energy markets, resource adequacy payment programs, transparent market operations, regional planning and an independent framework. The benefits that these features provide to RTO members are not insignificant and may induce RTO membership on their own.

Q48. Is the existing 50 basis point adder appropriately scaled to encourage the formation and continuance of RTO/ISO arrangements?[62]

No comment.

[61] NOI, at P 35.
[62] NOI, at P 35.

K. Recovery of Abandoned Plant

Q49. How does the current incentive allowing recovery of 100 percent of prudently incurred abandoned plant costs affect the sharing of risks between investors and customers? Are there reasonable conditions or safeguards that could be imposed to ensure risks are appropriately allocated? For example, should recovery of abandoned plant costs be exclusive of carrying charges? Should carrying charges exclude any ROE incentive?[63]

Under the abandoned plant incentive, the only costs for abandoned plant not subject to recovery are imprudently incurred costs, which would have been disallowed even if the plant went in service. The Commission appears to be asking if full recovery of the costs of abandoned plant appropriately allocates the risks associated with plant abandonment, or are there certain conditions under which it should allow only partial recovery of those costs. The current Commission incentive policy allocates 100 percent of the risk of abandoned plant to ratepayers. This appears to be appropriate if the abandonment was approved as a part of a stakeholder approved change in the transmission plan on economic grounds, where it was determined that abandoning one project and starting an alternative project would be more cost effective. The calculations for this should compare the costs of completing the project underway minus any economic benefits to the costs of the alternative project plus the costs of the abandoned project minus any economic benefits.

If full or partial recovery of abandoned plant is allowed, since the abandoned plant is not used and useful and will not provide the transmission capacity, its costs should be amortized over an appropriate period of time. The Commission appears to be asking whether or not an appropriate carrying charge should be included in the amortization, and if so should those

[63] NOI, at P 36.

charges exclude any ROE adder. Because abandoned plant is not used and useful, ROE adders should be excluded from the calculation of any ongoing carrying charges.

In addition, the Commission may be asking whether carrying charges already incurred on the project (i.e., interest accrued during construction) should be included in the recovery of abandoned plant, and if so, should that interest included any ROE adder. Since the plant is not used and useful, it seems more appropriate to include only interest on debt incurred during the construction period. In addition, it could also be reasonable to share the cost by allowing recovery of the abandoned asset, without recovery of carrying costs incurred during the recovery period.

Q50. Should abandoned plant costs be prohibited in instances where an affiliated project eliminates the need for a transmission project?[64]

The Commission should closely examine any attempt to recover abandoned costs on a project where the same developer has eliminated the need for one project by proposing another project. The presumption in such cases should be against abandoned cost recovery. However, in special cases where the stakeholders in a regional transmission planning process have determined the abandonment to be the proper course of action, consideration may be given by the Commission.

Q51. Are there additional measures that can be taken to either limit the risk of abandonment, or mitigate the impact of allowing recovery of 100 percent of abandoned plant costs on customers?[65]

The Commission can limit the risk of abandonment and mitigate the impact of allowing recovery of 100 percent of abandoned plant costs on customers by better defining what factors

[64] NOI, at P 36.
[65] NOI, at P 36.

are considered to be "outside of the control" of the requestor seeking recovery of abandoned plant and better defining the prudence of costs incurred. Doing so will remove a significant amount of uncertainty regarding the conditions under which developers can expect to recover any abandoned costs.

Q52. Some intervenors in various transmission incentives proceedings have raised concerns that the incentive of allowing 100 percent recovery of prudently-incurred abandoned plant costs could encourage applicants to pursue projects of greater risk. How should the Commission consider and address this factor?[66]

The Commission should require the analysis of risks of alternative projects in the transmission planning process. This includes the risk of abandonment. Such analysis would need to identify the events and actions which could cause abandonment. The higher the risk of abandonment, the higher the floor of net-benefits that the project would need to provide before it would be considered viable. Transmission planners also need to account for cost-side risks in developing a range of likely costs. For example, a transmission upgrade through existing right of way has a lower risk than transmission planned along new right of way. Transmission through or close to environmentally sensitive land will have a higher risk of being rerouted than transmission that is more distant. Certain types of non-standard transmission upgrades may have higher risks than more standard types of upgrades. All of these various risk factors should be taken into account.

In the case of upgrades associated with improved economic efficiency, the benefits from various projects may have different risks. Sensitivity analysis should be used to determine comparable ranges of benefits for alternative projects. Ultimately, projects should be chosen in a

[66] NOI, at P 36.

way that takes into account varying risks associated with competing alternatives. At this time, the OMS is not recommending a formulaic approach, as this type of analysis is in its beginning stages. But the Commission should set a policy that requires transmission planners to include and evaluate risks related to both costs and benefits. Furthermore, the incentive should not be applied in such a manner that owners become indifferent between low risks and high risk alternatives. Where the Commission determines that the company did not make an effort to minimize the likelihood of abandonment, the Commission should not provide this incentive.

Q53. Should the Commission allow recovery for partial abandonment of projects? If so, how should partial abandonment be defined? What criteria should the Commission consider when deciding whether a project has been partially abandoned? What would be the consequences of the Commission allowing recovery of abandoned plant cost for a portion of a project and later denying recovery of abandoned plant costs for the entire project (e.g., finding that abandonment of the full project was under the control of the project developer)?[67]

No comment.

Q54. If the recovery of abandoned plant costs were made contingent on the abandonment or cancellation of all or a substantial portion of a transmission project, how should the Commission define a "project" for the purpose of applying the abandoned plant incentive? The Commission has stated that several individual transmission projects may be characterized as a single project, or as several individual projects, depending on the showing made by the applicant. Should this characterization limit how an applicant may recover abandoned plant costs?[68]

No comment.

Q55. If a project developer is granted the incentive for 100 percent recovery of abandoned plant costs, but is denied a request to recover abandoned plant costs under this incentive, then is it appropriate to recover those

[67] NOI, at P 36.
[68] NOI, at P 36.

costs through other accounting treatments in a subsequent section 205 filing? If so, what accounting treatments would be appropriate?[69]

No comment.

Q56. If a utility receives recovery of abandoned plant costs incentives and subsequently abandons its project, what rate of return (including incentive ROE adders), if any, should be applied to the abandoned plant costs until the costs are ultimately recovered in rates?[70]

It would be reasonable that carrying costs for abandoned projects should not include the incentive ROE. This is because the abandoned plant is not used and useful and will not provide the transmission capacity that the incentive was intended to compensate/incent. It could also be reasonable to share the cost by allowing recovery of the abandoned asset, without recovery of carrying costs incurred during the recovery period.

Whether or not any return on equity should be included for abandoned plant or should only interest on debt be used also needs to be considered. The OMS understands the argument that the cost of money to a utility, as a corporate entity, is considered to be its average costs that includes various form of debt and equity. However, in the case of abandoned plant, the question needs to be raised as to whether stockholders are entitled to receive a return on plant that it is not used and useful at the expense of ratepayers having to provide that return. The OMS believes that allowing recovery of abandoned plant can be justified, but increasing the interest costs over the amortization period is going beyond what ratepayers should have to pay for plant that will never provide them with services. Moreover, such a policy treats the abandoned plant as a cost of the project that displaces the abandoned project.

[69] NOI, at P 36.
[70] NOI, at P 36.

L. Construction Work In Progress (CWIP) in Rate Base

Q57. What are the appropriate bases for evaluating a request to recover 100 percent of CWIP? Does including 100 percent of CWIP in rate base more appropriately address project specific risks and challenges or the aggregate risks and challenges associated with all projects an applicant is undertaking in a certain time period? If the aggregate risks and challenges are more appropriately addressed by including 100 percent of CWIP in rate base, how should the risks be reconciled with a Commission policy to evaluate risks and challenges on a project specific basis?[71]

Including 100 percent CWIP in rate base is viewed favorably by the investment community, regardless of the specific risks and challenges of the project and should be considered in the first step of the reforms proposed in these comments. The cash flow provided by CWIP substitutes for external financing and reduces the need for project developers to raise capital, and therefore can have a significant impact on the issue of the ability of the applicant to raise capital. This can be a significant benefit to transmission developers, particularly in a difficult capital market.

If the Commission wishes to limit the use of this incentive to only selected projects or applicants for which the early recovery is needed to provide access to capital for the applicant; some factors that could be considered are: (1) Whether or not the applicant has a significant amount of other investments already providing earnings; (2) The financial backing of the project owner – whether or not it is a new independent Transco or it has financial backing from established utilities or utility holding companies; (3) The time-line for construction expenditures, as well as the overall size of the project; and (4) Evidence that transmission financing is currently under distress.

[71] NOI, at P 37.

Q58. What is the impact on ratepayers of allowing 100 percent CWIP in rate base prior to commercial operation? What kind of information should an applicant submit to make a showing that granting 100 percent CWIP will benefit consumers?[72]

No comment.

Q59. In addition to the rate impact data required under 18 C.F.R. § 35.13(h)(31) and (32), what rate impacts tests could be considered in evaluating a request for including 100 percent of CWIP in rate base?[73]

No comment.

Q60. Should the CWIP incentive not apply or be suspended in circumstances where an incentives project has been suspended for an indefinite period of time and there is no additional construction activity on the project?[74]

No comment.

Q61. In the past, the Commission implemented a phasing-in of rate treatments to limit their rate impact to consumers. Should the Commission consider such limits for certain incentives such as CWIP?[75]

No comment.

Q62. If the applicant is granted an incentive ROE adder and 100 percent CWIP in rate base, should the incentive ROE adder be applied to 100 percent of CWIP included in rate base?[76]

No. It would be reasonable that carrying costs for CWIP should not include the incentive ROE since receiving a current return on CWIP is in itsself a benefit/incentive.

[72] NOI, at P 37.
[73] NOI, at P 37.
[74] NOI, at P 37.
[75] NOI, at P 37. (footnote omitted)
[76] NOI, at P 37.

M. Hypothetical Capital Structure

Q63. Is there a reasonable debt to equity split, or a procedure for determining such, that should be applied generally to future applications, or that can be applied generally to classifications, such as a general split for publicly owned projects and a general split for investor owned projects? Or is this best suited for case by case determination? What kind of information should an applicant provide in order to support an application for a hypothetical capital structure?[77]

Since increasing the percentage of equity has the same impact as placing a higher ROE on a lower percentage of equity, a hypothetical capital structure incentive should not normally be granted.

Q64. Is there a reasonable point in time at which the actual capital structure should be required to match the hypothetical capital structure and that should be applicable generally to future applications?[78]

No comment.

N. Pre-Commercial Cost Recovery

Q65. CWIP related costs should not be recorded as pre-commercial costs. What additional measures could be considered to prevent the inclusion of costs as pre-commercial that should appropriately be recorded as CWIP and recovered over the useful life of a project? In the case of deferred recovery, would limiting the period of time that carrying charges will be allowed help to ensure timely development of a project and guard against unreasonable delays?[79]

To the extent the Commission permits carrying charges on deferred recovery, it should be limited to a defined period when the Commission grants the incentive. This would ensure timely development of a project while protecting the interests of ratepayers. For example, if a developer encounters serious obstacles to developing a project or a project is placed in abeyance

[77] NOI, at P 38.
[78] NOI, at P 38.
[79] NOI, at P 39.

by the regional planning organization, it is critical to ensure that a developer does not have an incentive to defer determining that the project should be abandoned. Limiting the period of time any carrying charges are allowed on deferred cost items is one way of doing this.

Q66. If incentives for both pre-commercial cost recovery on a deferred basis and 100 percent recovery of abandoned plant costs are granted, is there a relationship between the two incentives such that the Commission should review the type of costs that included in the regulatory asset, the allowance of carrying charges, or the time period over which a regulatory asset is recovered in rates for pre-commercial cost recovery?[80]

The answer to this question depends on when a developer starts to recover pre-commercial costs. If a developer is permitted to recover costs associated with a regulatory asset concurrent with cost recovery with CWIP, then it will be imperative to insure that double collection of costs has not occurred. If the recovery of costs associated with the regulatory asset does not start until the project is placed in service, the risk of double recovery of costs is minimized.

The Commission needs to clarify how costs will potentially be recovered through its various incentive mechanisms. The Commission has largely deferred consideration on these items until future section 205 filings. This places a burden upon ratepayers since it makes it difficult for ratepayers to determine the impact of various incentive grants upon the rates when evaluating an applicant's petition for incentive rate treatment. Increased clarity on these issues will benefit ratepayers.

With respect to carrying charges on pre-commercial expenses, if the project is granted an abandonment incentive, the carrying charges should reflect the reduced risk to the developer.

[80] NOI, at P 39.

This means ROE incentive adders and other incentive treatment such as hypothetical capital structure should not be used in the determination of the carrying charge. Furthermore, carrying charges on the regulatory asset should only be allowed to accrue over a finite period of years so as to remove any incentive for the developer to delay declaring a project is abandoned.

> Q67. Does the current practice of allowing carrying charges on deferred recovery of pre-commercial costs at the overall cost of capital, including incentive ROE adders, appropriately balance the sharing of risks of transmission project development between utility applicants and customers and affect the overall level of pre-commercial costs? How should this practice be changed to better allocate the risks between applicants and customers and to ensure that pre-commercial costs are reasonable?[81]

The current practice does not appropriately balance the risks of transmission project development between developers and ratepayers. At a minimum, incentive ROE adders should not be applied to the regulatory asset created to recover deferred costs.

Furthermore, the carrying charge should be determined using the actual capital structure of the developer rather than the hypothetical capital structure used in the development phase of the project. This is appropriate since the asset will not be amortized until the project is placed into service at which point the actual capital structure of the developer should be known.

> Q68. Should the Commission change the way it determines what constitutes an "advanced" technology that is appropriate for incentives?[82]

No comment.

> Q69. Section 1223 of EPAct 2005 defines advanced transmission technology and lists technologies that fall within that definition. How should the

[81] NOI, at P 39.
[82] NOI, at P 44.

Commission account for what Order No. 679 identified as the evolving nature of technology?[83]

No comment.

Q70. Does the above-noted standard -- examining whether a proposal reflects a new or innovative domestic use of a technology that will improve reliability, reduce congestion, or improve efficiency -- strike an appropriate balance?[84]

No comment.

Q71. Should an applicant's level of previous experience with a technology be a factor in determining whether that technology is "advanced" for purposes of evaluating a request for incentives? If an applicant has previous experience using a technology that otherwise has not been widely adopted, should that applicant's proposed use of the technology be considered "advanced"? If an applicant has no previous experience in using a technology that is otherwise widely adopted, should that applicant's proposed use of the technology be considered "advanced"?[85]

No comment.

Q72. Where the Commission grants an incentive ROE adder for the use of advanced technology, should the adder apply to the entire cost of a project, or just to the advanced technology?[86]

No comment.

Q73. Should incentives for advanced technology continue to be assessed on a case-by-case basis, or would it be preferable and practical to establish generic standards for advanced technology incentives? For example, should the Commission consider identifying particular technologies or applications of technology that may be appropriately granted incentives?[87]

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[83] NOI, at P 44.
[84] NOI, at P 44.
[85] NOI, at P 44.
[86] NOI, at P 44.
[87] NOI, at P 44.

No comment.

Q74. What types of incentives, e.g., incentive ROE adder, accelerated depreciation, will be most effective in encouraging the deployment of advanced technology?[88]

No comment.

III. CONCLUSION

The OMS appreciates the Commission's initiative to re-visit its transmission incentive rate policies. The OMS respectfully offers the advice and recommendations herein for the Commission's consideration.

The OMS submits these comments because a majority of the members have agreed to generally support them. Individual OMS members reserve the right to file separate comments regarding the issues discussed in these comments. The Iowa Utilities Board, the Kentucky Public Service Commission, the Manitoba Public Utilities Board, and the Michigan Public Service Commission abstained from voting on this pleading.

Respectfully Submitted,

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[88] NOI, at P 44.