

OMS Regional Planning Workgroup’s Feedback on Components of MISO’s FERC Order 1000
Right of First Refusal Compliance
5/21/12

The following are comments provided by the OMS Regional Planning Workgroup (RPWG) and are therefore not to be considered as an official OMS acceptance or rejection of any proposals that have been presented to stakeholders to date. Note also that these comments do not represent a unanimous agreement amongst workgroup members and that there are workgroup members who have differing viewpoints or concerns.

1. Selection of Transmission Project Developers
a. Process Characteristics

Many OMS RPWG members believe that a good process to evaluate all transmission projects should be a joint MISO and State Agencies process, which is developed with open and transparent stakeholder participation, including participation by relevant state agencies, and with due regard to state jurisdictional issues.¹ A key value provided by MISO’s Regional Transmission Operator (RTO) construct is that MISO is expected to act as an independent entity, giving MISO an important role in this process. Further, MISO has adequate and necessary resources and analytical tools – as well as access to information – in order to carry out this task. MISO is generally capable and is well positioned to conduct economic and engineering feasibility analyses of all submitted or proposed projects that would meet identified needs. MISO also can receive necessary input data, including confidential or non-confidential information, from independent project developers and incumbents and non-incumbent developers. It can make independent and objective evaluations without the confidential information issues which would be raised by third parties.

In the opinion of many OMS RPWG members, assigning a third party to do this work would appear to increase the costs of project development and consume additional analytical time. Net benefits derived from such third party analysis or an external audit may not be marginally better and may delay project implementation. Further, any marginal increases in market confidence that could be gained from a third party evaluation may not be worth the additional costs that consumers would be asked to pay through rates, on top of what they already pay for MISO’s technical analyses. Adding an additional party to make selections would simply create an added layer of complexities and expense that should be avoided.

Other OMS RPWG members believe that there are inherent aspects of RTO business structure that call into question the ability of the RTO to select project developers in a completely unbiased way. Because the RTO is a *transmission* organization, it may have an inherent bias toward transmission options simply

¹ OMS RPWG members realize that States and Commissions may have prejudgment concerns.

because that is the area of the organization's primary expertise. In addition, because membership in an RTO is voluntary on the part of transmission owners, and because the RTO needs a sufficient base of transmission owner membership to remain viable as a business entity, RTOs may feel some pressure to lean in favor of certain project developers and against others. This concern is increased by the specific obligations that MISO is required to perform with respect to the transmission owners as specified in the Transmission Owners Agreement. This is not an indictment of MISO or any other RTO, just a realistic assessment of business incentives. These business realities tend toward using an independent third-party evaluator in the developer selection process. Oversight of the third party evaluator could lie jointly with the MISO Board and the Board of Directors of the OMS, for example. As with market power monitoring, where special reporting arrangements have been established for the independent market monitor to eliminate the appearance of interference from MISO management, special arrangements for oversight of the third party project developer evaluator would also be needed.

b. **Proposed Qualification Criteria: "Cost to Consumer"**

All of the proposals on the ballot, as well as the MISO strawman contain the term "Cost to Consumer". In the MISO April 26 strawman, these costs include:

- Estimated total of the project;
- Financing costs;
- FERC incentives;
- Revenue Requirements; and
- Lifetime Cost of Project to Consumers.

The RPWG members suggest that these costs, especially financing, the return on equity (inherent in "FERC incentives"), and ultimately revenue requirements, be subject to a rigorous competitive bidding process among interested transmission developers. While both models that have been put forth list "Cost to Consumer" as an attribute, it is unclear whether the proponents mean the total construction cost of the project, or the total cost of the project including financing and financial return elements. We want to be clear that "cost to consumer" entails all costs and that while construction costs are sometimes difficult to estimate and control, the financial elements of a project are controllable by the project developer, and should be subject to competitive bidding.

Regulation of utilities exists because economic theory shows us that if a natural monopoly were not regulated, it would maximize its profits by restricting the output of its good or service, and raising the price above the result that would occur in a competitive market. Regulation exists to "force" a more competitive outcome: a lowering of the price and an increase in the output of the good or service. This financial regulation of natural monopolies stood the test of time when states regulated utilities that operated as entities unto themselves. We now have wholesale markets in electricity products, and some states have undone the traditional regulatory model. On the transmission side, much of the rate base has moved from state regulatory control to federal control. In this environment, the traditional economic

theory of regulation has moved from the states to FERC for implementation, although states do retain some authority over transmission in the form of state rights of first refusal, state siting and CPCN approvals, and some aspects of cost recovery from retail customers.

FERC has recently been promoting two conflicting policies: incentive return-on-equity awards to prospective transmission projects, and competition for transmission developers for the same transmission project. These two policies cannot and should not coexist. When multiple parties are competing for rights to develop a project, then no rate incentives are needed. Under the current incentive rate policy, FERC has, in many cases, granted incentives to projects whose details have not been well-specified and that have not specifically demonstrated their need. In areas of the nation with RTOs, FERC has sometimes made the implementation of the awards contingent upon receiving approval in an RTO transmission planning process. FERC Order 1000 eliminates federal right of first refusal for some project types by ordering RTOs and transmission planning regions to develop a method to choose among competing transmission projects that meet identified transmission needs. FERC indicated that it will entertain a variety of ways to accomplish this goal, based on what the stakeholders in the regions determine would best meet their needs.

The competition that FERC seeks and that RTOs will implement should consist of competition not only on all of the non-financial aspects of developing transmission projects, but just as importantly on all price components of the projects. The price attributes include not just total project cost estimates (which are commented on further in section 2), but on the financing and return portions of a project. Specifically, potential transmission developers, notwithstanding any previous FERC orders that they might have, should be required to compete on the basis of ROE, fixed charge rate, and annual revenue requirements. These factors are wholly within the control of potential competitors, in contrast to construction cost totals, which will undoubtedly vary from the estimate. Rather than, or in addition to, competing on cost estimates that will vary from actual construction costs, developers should have the opportunity to competitively bid on the projects using those financial factors in their control. This competitive bid process on the financial side will help to ensure the competition that FERC seeks to implement with Order 1000. Otherwise, we are left with a faux competition on non-financial factors while the end result is a stream of non-competitive financial returns paid for by the retail consumers in the MISO footprint.

An auction or market model is commonly used in many RTOs. Auctions are used in day-ahead and real-time energy markets, in ancillary services markets, in allocating financial transmission revenue rights and annual revenue rights, and in the procurement of future capacity. Indeed, many of the same large companies that own generation and transmission facilities and already compete in the above markets are the same companies (or newly created affiliates and joint ventures with other companies) competing for the new transmission projects. RPWG members encourage these companies to help

stakeholders develop the market rules to ensure a truly competitive financial bidding process for MISO transmission projects not subject to the federal ROFR.²

Another area of FERC Order 1000 directs transmission providers to consider transmission planning for public policies that exist in the states. One area of public policy often discussed in this area is planning for renewable portfolio standards across the states. Each state's main "public policy", as well as FERC's, is to ensure just and reasonable rates. Opening up transmission projects not subject to ROFR to rigorous financial competition should help to ensure meeting this primary public policy for all of the regulatory agencies on behalf of the public.

Paragraph 328 of FERC Order 1000 directs MISO to "describe a transparent and not unduly discriminatory process for evaluating whether to select a proposed transmission facility in the regional transmission plan for purposes of cost allocation" and the MISO-identified requirement C8 (paragraphs 332, 335, 336) states MISO "would need to have a fair and not unduly discriminatory mechanism to grant an incumbent transmission provider or nonincumbent transmission provider the right to use the regional cost allocation method for transmission facilities selected in the regional plan for purposes of cost allocation". A competitive bidding process on all aspects of cost, including the financial elements, will help to ensure that MISO meets these directives of Order 1000.

Paragraph 259 of Order 1000 states, in part:

"For example, the public utility transmission providers in a region may, but are not required to, use competitive solicitation to solicit projects or project developers to meet regional needs."

And:

"Within the implementation framework adopted below, the Commission provides each region with the flexibility necessary to identify the modifications to existing transmission planning processes that may be required as a result of removing federal rights of first refusal from Commission-jurisdictional tariffs and agreements."

This paragraph suggests that if MISO filed a comprehensive competitive bidding compliance process as suggested here, it would take precedence over FERC-ordered incentive rates that may have been granted to a potential project. It is imperative that all developers are subject to a robust competitive process that includes all aspects of cost, and so once the MISO process is in place, it will not matter, nor be necessary, for a developer to file a project at FERC asking for incentive treatment in advance of the MISO planning process. Once Order 1000 compliance is in place, it appears that only the developers

² Some states enacted a right of first refusal at the state level, which will require coordination as the processes of building multi-state transmission moves ahead.

selected in the planning process would need to file at FERC, and even that may not be necessary depending on the outcome of the transmission planning project auction.

A competitive bidding process is often used in federal government auctions for bandwidth, and drilling or mineral rights, and in the procurement of highway construction projects. In the electricity transmission area, the nation of Brazil has employed competitive bidding for transmission projects since 1999. It uses a revenue cap type regulation by having bidders compete on the basis of revenue requirements over a 30 year period.

2. *Cost Containment Measures*

Irrespective of what is the ultimate selection process chosen for this Order 1000 compliance requirement, it is important to hold developers accountable, after-the-fact, to their cost estimates. To assist with this goal, once the developer is selected, more standardized cost estimates and information, project-specific information, and clear schedules for project timelines should be provided that would allow for review, comparability, and clear expectations of costs and timelines. RPWG members support review of standardized cost estimates and project specific information and schedules with transmission developers, transmission planners, and appropriate Federal and State Agencies to ensure a clear understanding of all costs, project specific information and timelines. To aid in a more efficient review by all, the standardized cost estimates should be compiled with the highest level of specificity (i.e., from cost per mile to the estimated amount and cost of construction labor).³ While this information would be more relevant later in the selection process, including more specificity at all stages would allow for better review of costs by stakeholders, including OMS.

Regardless of whether MISO ultimately elects a process where a transmission project constructor is chosen at the beginning or end of an MTEP cycle, more information about a transmission developer's cost estimate should assist in the best projects being selected. RPWG members believe this process will assist in providing more cost containment. Finally, having MISO rerun cost-benefit tests for cost overrun projects may assist in determining whether costs disallowances should be considered.

For after-the-fact accountability, the RPWG members support approaches such as requiring cost overruns of more than a certain amount (for example 5 percent) to be clearly explained and justified prior to any rate recovery. Approaches such as setting lower returns on equity for cost overruns, sharing of cost overruns, or capping of costs and not allowing full recovery should be considered if clear justification for cost overruns is not provided. Of course, in such a process recovery of cost overruns that are clearly beyond the builder's control could be allowed to the extent they were truly unavoidable.

³ While the RPWG acknowledges that MISO currently collects specific details; we want to stress our support for compiling a high level of specificity. SPP's Balanced Portfolio Report provides a good example of the level of specificity the RPWG would like to see, as a minimum amount of information.

<http://www.spp.org/publications/2009%20Balanced%20Portfolio%20-%20Final%20Approved%20Report.pdf>

However, RPWG members believe it is important that accountability become a clear expectation as to the large investments for which electricity consumers are required to pay.

3. Concerns with FERC's Transmission Incentive Rates that should be fixed in FERC's Order 1000 process

In July 2006, in Docket No. RM06-4-000, FERC approved its Final Rule on Incentives for Transmission Investment. Key provisions of the rule included:

- Incentive rates of return on equity (ROE) for new investment by public utilities (both traditional utilities and stand-alone transmission companies, or transcos);
- Full recovery of prudently incurred construction work in progress;
- Full recovery of prudently incurred pre-operations costs;
- Full recovery of prudently incurred costs of abandoned facilities;
- Use of hypothetical capital structures;
- Accumulated deferred income taxes for transcos;
- Adjustments to book value for transco sales/purchases;
- Accelerated depreciation;
- Deferred cost recovery for utilities with retail rate freezes; and
- A higher rate of return on equity for utilities that join and/or continue to be members of transmission organizations, such as (but not limited to) regional transmission organizations and independent system operators.

RPWG members have concerns with FERC's transmission incentives rates, including the overly generous benefits that lead to higher transmission costs and the negative impacts to the MISO RTO planning process. The FERC-approved 12.38 to 12.88 percent ROE incentives are overly generous and appear to result in focus on building of transmission as the first solution, rather than seriously considering generation and demand response alternatives. RPWG members are very concerned (as briefly mention in section 1) with the arbitrary parallel process FERC has created where these incentive transmission projects are first approved at FERC with their incentives, rather than initially going through an appropriate regional planning process. In the regional planning process, transmission owners, generation owners, State Agencies, and other stakeholders have opportunities to weigh in on changes to a proposed project and to become comfortable with the transmission projects.

FERC incentives cause significant problems with the open and transparent planning processes that the FERC has directed to be established. While the FERC incentive rates may be appropriate for regions that have had difficulty building transmission or where there is not a robust RTO planning process, for purposes of the MISO RTO, such incentives simply add unnecessary costs and provide the perverse effect of skipping to the front of the line in the MTEP process. Additionally, the FERC transmission incentive rates focus on transmission and do not consider other generation and demand response options or obtain the most cost effective transmission option. The FERC incentive rate policies will likely lead to more abandoned plant costs as a result of a parallel process where transmission planning is not well vetted through the MTEP process, and multiple projects obtaining FERC incentive rates, where only one is needed to address a particular transmission need identified in the regional planning process.

RPWG members note that in 2006 when FERC approved these transmission incentives the economy was growing faster and financial incentives may have been more appropriate for the conditions of the market at that time. However, with the current financial market problems that began in 2007-2008, the financial incentives are overly generous. FERC Order 1000 allows for more competition of transmission projects and more reasonable costs for ratepayers; however, FERC's transmission incentive rates policy significantly and unnecessarily increases the costs assigned to ratepayers. RPWG members also believe that MISO should be concerned with the havoc FERC's transmission incentive policy may impose on the transparent and comprehensive regional planning process that MISO is trying to establish.

For all of these reasons, RPWG members recommend that MISO develop project evaluation and selection processes and project developer processes for competition on all project elements (including developers' financial characteristics) so that the weaknesses and flaws of FERC's incentive rate policies have reduced negative impacts on the regional planning process

Additional Questions about MISO Discussions to Date:

Below are some ongoing issues and questions to which RPWG members would like to see further consideration given. This list is not exhaustive; however it represents some issues that members would like to learn more about.

1. After proposing a project under either the sponsorship or hybrid models, can the sponsor sit back & bring nothing else to the planning phase, but still earn the winning bid under the sponsorship model as they originally proposed the project?
2. At the other end of the spectrum, if changing a proposed project means it materially becomes a different project, does the sponsorship or hybrid model simply conclude that whichever entity suggests the last accepted edit becomes the new "sponsor"?
3. If an entity is given some kind of preference for either sponsoring or participating in the development of a project, how would their selection as the winning bidder ensure any kind of prudent cost containment?

4. If an original project were proposed in a MISO-wide study, such as the Regional Generation Outlet Study (RGOS) and then pushed into a portfolio analysis, such as MVP, but then a portion of the original project changed in the new analysis, would the original sponsor still be given priority under a sponsorship or hybrid process? How would non-incumbents fit in at that point, or would they be given a chance?
5. Collaboration aspect of the Comprehensive Evaluation Model is not well understood. What does it mean when companies collaborate on a project; would the project then move out of the competition realm?
6. The Competitive Bidding Alternative seems to have quite a few issues that need to be defined before assuming the “lowest cost” project and developer are chosen. The following are just a few issues concern design, pricing, and project uncertainties that could neutralize the benefits of a bidding process that assumes the price is a significant way of determining the “lowest” cost. The Risk Assessment aspect seems to be missing.
 - a. DESIGN
 - i. Is there only one transmission voltage solution as the solution? Are IPPs required to bid? Are demand side markets required to bid?
 1. If there is a combination of generation and transmission when is that partnership known for approval?
 - ii. Are state commissions allowed to view lower voltage solutions with less time of viability?
 - iii. What load forecast would be used for which period of time of evaluation? 20 year planning, 40 year financial asset value, or 80 year physical life?
 - iv. What future scenarios are considered?
 - v. What market economics are included in the benefits?
 1. To which customers?
 2. Over what time period?
 3. Are any other operational benefits or “insurance” values allowed?
 - vi. Do you present value the different alternatives? And at what inflation and discount rates?
 - vii. Right Of Way design issue
 1. Will the routes be known?
 - a. Environmental, highway and customer conflict
 2. If there are multiple routes, how are the connecting corner structures priced out?
 3. Will forced double circuit of existing transmission be required?
 4. Will distribution be relocated? Overhead? Underground? Other side of the road?
 - b. PRICING
 - i. Assume a 40 year financial value for starters, what is the true up Present Value period?

- ii. How does one cross evaluate ROE, with variations of CWIP, AFUDC, pre-cert expenses, etc.?
 - iii. How do environmental and other permits get detailed.
 - iv. Is the pricing viewed from the State with the TO rate payers, the state's TO footprint, or MISO?
 - v. Are dollars in approval year? In bid year? Or completion year? What is the present value attributes?
 - vi. Or does one have a bid range with an associated price guarantee range?
- c. PROJECT MANAGEMENT (PM)
- i. Cost uncertainty is likely to be a bigger price factor to possibly negate the presumed savings of a multi-party bid.
 - ii. Are labor and materials allowed to be indexed?
 - iii. What would a cost overrun allowance be?
 - 1. Allow for a nominal 5% to 10% for projects that take years?
 - 2. Allow zero as some have suggested? But will all bids go up to cover risks?
 - 3. How would one have route changes to meet unknown conditions at certain structures?
 - iv. How does the PM figure the cost of construction limitations without a specific route?
 - 1. Highway work only night and weekends for certain activities
 - 2. Only winter work on certain wetland areas
 - 3. Invasive species mitigation, agricultural disease mitigation, etc.
 - v. How do weather events get recovered, allowed, or denied?
 - vi. Do other supply chain disruption events get financial consideration?