

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

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

**COMMENTS SUBMITTED ON BEHALF OF
THE PUBLIC UTILITIES COMMISSION OF OHIO**

September 12, 2011

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INTRODUCTION

Section 1241 (*Transmission Infrastructure Investment*) of the Energy Policy Act of 2005 (EPAc 2005) added Section 219 to the Federal Power Act (FPA). Section 219 established mandates to promote investment to ensure the reliability of the bulk power transmission system and to reduce the cost of delivered power to customers by reducing transmission congestion. Section 219 requires the Federal Energy Regulatory Commission (FERC) “promote reliable and economically efficient transmission and generation of electricity by promoting capital investment,” to “provide a return on equity that attracts new investment in transmission facilities,” and to “provide for incentives to each transmitting utility or electric utility that joins a Transmission Organization.”¹ In addition, Section 219 mandates that “all rates approved under the rules adopted pursuant to this section, including any revision to the rules, are subject to the requirements of

¹ Section 219 of the Federal Power Act at 16 U.S.C. 824s, ¶¶ (b)(1), b(2) and (c).

Sections 205 and 206 that all rates, charges, terms, and conditions be just and reasonable and not unduly discriminatory or preferential.”²

BACKGROUND

On July 20, 2006, FERC issued Order No. 679, *Promoting Transmission Investment through Pricing Reform*, in Docket No. RM06-04-000.³ Order No. 679 established criteria and procedures by which transmission owners can receive “incentive-based” rate treatments for the transmission of electric energy. FERC’s Order No. 679 declined to adopt specific criteria or conditions that applicants would be required to meet in order for projects to be considered eligible for incentive rate treatment. Instead, FERC required that each applicant satisfy the statutory threshold in Section 219(a), by demonstrating that the facilities for which it seeks incentives either ensure reliability or reduce the cost of delivered power by reducing transmission congestion. Once this threshold is realized, the applicant then must demonstrate that there is a nexus between the incentive sought and the investment being made (*i.e.*, that the incentives being requested are “rationally tailored to the risks and challenges faced by a project”).

On May 19, 2011, FERC issued a Notice of Inquiry (NOI) in the above-captioned proceeding inviting input concerning the scope and implementation of its transmission incentives regulations and policies consistent with FERC Order 679. Specifically, FERC’s NOI notes that this investigation has been initiated to ensure that its incentives, regulations, and policies are encouraging the development of transmission infrastructure in a manner consistent with FPA Sections 205, 206, and 219. In addition, FERC’s NOI

² Section 219 of the Federal Power Act at 16 U.S.C. 824s, ¶ (d).

³ 116 FERC ¶ 61,057.

observes that it has been nearly five years since FERC promulgated its transmission incentives regulations pursuant to the directives of Section 1241 of the EPAct 2005 and that it has received over 75 applications for transmission incentives. Consequently, FERC determined that it is timely to evaluate its Order 679 incentives policies. Comments are due on or before September 12, 2011. The Public Utilities Commission of Ohio (Ohio Commission) herein respectfully submits its comments responding to FERC's May 19, 2011 NOI.

DISCUSSION

A. General Remarks

FERC should be commended for aggressively pursuing Congress' transmission incentive policies. While the Ohio Commission is supportive of FERC Order 679, FERC should ensure that the incentive granted is closely tailored to the advanced technology being deployed and/or the high-risk nature of a transmission project. In addition, FERC must be certain that, upon granting special rate treatment⁴ or incentive ROE adders, its decision is consistent with Section 219 (a) which mandates that consumers benefit by ensuring reliability and reducing the cost of delivered power, and Section 219 (d) which dictates just and reasonable rates that are not unduly discriminatory or preferential. That is, the Ohio Commission maintains that FERC should be cautious not to cross the fine line between incenting the development of new transmission facilities to the benefit of consumers via lower rates and increase reliability and adopting policies that result in over

⁴ Special rate treatment would be authority for, among other things, full recovery of construction work in progress (CWIP), preconstruction costs, prudently incurred abandoned facilities, and/or accelerated depreciation for new transmission projects.

compensation to transmission providers. An overly aggressive compensation design, resulting in unintended over compensation, is detrimental to customers and the general economy. Consequently, the Ohio Commission recommends that FERC undertake comprehensive measures to ensure over compensation does not occur.

First, as a general policy, FERC should not allow the ROE adders for routine, low or moderate risk projects. Incentive ROE adders should not be routinely granted in that such approvals are characteristic of the norm as opposed to the exception. That is, the Ohio Commission supports ROE adder incentives when a project faces heightened risk and when the incentive requested is closely tailored to match anticipated consumer benefits. Consequently, the Ohio Commission maintains that ROE adder incentives are appropriate only for those projects that would not be likely to proceed but for the incentives. The Ohio Commission recommends that FERC establish a framework for incentives that characterizes projects based upon likelihood of attracting private investment. Ranging from those that are routine, mandated by contract, mandated by law, etc. which should have little difficulty attracting investment to those implementing new, untested technologies in challenging physical siting conditions with long lead times prior to commercialization (*e.g.* the construction of transmission facilities in the Atlantic Ocean).

When arriving at transmission project incentives pursuant to Section 219(a), the Ohio Commission maintains that FERC should develop common sense principles or criteria for determining when incentives are needed and are appropriate to ensure that consumers benefit from the construction of transmission facilities that reduce cost of delivered power by reducing congestion. To qualify for incentives, applicants should be

required to pass the statutory test that demonstrates, under a defined set of criteria, the proposed incentives are appropriate and tailored to the specific project, which result in significant expected economic benefits over a range of planning scenarios. The economic threshold test adopted should be based on “expected value” of the new proposed facilities over a range of planning scenarios. The Ohio Commission observes that while a proposed project may not result in economic value in each and every future scenario, the overall value of the project in a range of likely futures must demonstrate that the new facility will materially reduce the delivered cost of power. In addition, the Ohio Commission maintains that this economic test should be evaluated through a transparent regional or inter-regional FERC Order 1000⁵ planning process. The Ohio Commission notes that these recommended changes deviate from standard methods of review for reliability planning that rely on a single forecast scenario and produce results that vary significantly from year to year with changes in inputs.

FERC Order 679 requires that, upon making a filing for incentive adders, an applicant must demonstrate: (1) that the facilities for which it seeks incentives either ensure reliability or reduce the cost of delivered power by reducing transmission congestion consistent with the requirements of Section 219; (2) that there is a nexus between the incentive sought and the investment being made (*i.e.*, the “nexus test”⁶) and; (3) that the resulting rates are just and reasonable. The Ohio Commission recommends that FERC include additional specific criteria for the application of the nexus test upon consideration of incentive adders pursuant to Section 219. Specifically, the Ohio

⁵ 136 FERC ¶ 61,051, issued July 11, 2011.

⁶ Order 679, at ¶ 26, issued July 20, 2006, 116 FERC ¶ 61,057,

Commission recommends that FERC adopt the following additional standards for review upon determining whether incentive adders are necessary:

1. Incentives must be tailored to facilitate development of high economic benefits projects that would not otherwise occur in a timely manner.
2. Incentives should be limited to elevated risk and high economic benefit projects. Moreover, incentives should not be available for routine projects, for low and moderate risk projects, and for mandatory projects.
3. Incentives should be limited to the percentage of expected economic benefits.
4. Incentives should be designed to address risks that could otherwise prevent a highly beneficial project from going forward. (Note: while transmission projects generally should proceed based on their economic merits and the willingness of benefiting parties to pay for them, there may be cases in which regulatory incentives for highly beneficial projects might be justified. In such cases incentives should be designed to provide the greater certainty needed for the investment to proceed.)
 - a. Incentives (or combinations of incentives⁷) should be tailored to address the type or types of risk involved in the project, *e.g.*:

⁷ Where multiple forms of significant risk are present, a combination of different forms of incentives may be appropriate for projects with significant expected economic benefits

Siting risk for projects in sensitive areas or subject to reviews by a large number of regulatory authorities, including the potential for abandonment.

- b. Business risk of changing conditions (e.g., exogenous business changes such as government policy or law changes outside of the company's control).
- c. Technology risk (*i.e.*, the risk of early adoption of new technologies intended to result in increased efficiencies).
- d. Rate impact risks from capital cost accumulation over long lead times, which, for example, may justify CWIP to spread out the rate impact from AFUDC upon project completion.
- e. Start up risk (*e.g.*, the risk that new entities may require CWIP to establish a pre-commercial cash flow and/or a hypothetical capital structure).

Second, in an attempt to further limit adverse ratepayer impact, the Ohio Commission recommends that FERC initiate a review of its 50 basis point ROE adder for RTO membership. Within its review, FERC should ensure that the RTO membership incentive is consistent with the requirements set forth in Section 219(d). The result of the review should allow FERC to demonstrate the rationale, policy and instances that would trigger certain levels of incentives. Moreover, if FERC's review reveals potential overcompensation via the ROE adder for RTO participation, FERC should consider reducing the annual adder and/or limiting the adder for subsequent projects of

transmission owners that are already a member of an RTO where that facility is being constructed.

Third, the Ohio Commission recommends that FERC develop metrics that compare the cost of its approved incentives to the customer benefits realized to determine whether adjustments to its policies are necessary. Without such quantification, it is impossible to determine whether FERC is maintaining the delicate balance to incent the construction of new transmission at reasonable rates to consumers consistent with Sections 219, 205, and 206 of the FPA to incent the construction of new transmission at reasonable rates and to increase reliability and to reduce congestion. The Ohio Commission, therefore, recommends that FERC issue a Notice of Proposed Rulemaking that invites comments on how best to develop measures to ensure that its policies are resulting in their intended goals to reduce overall rates to consumers.

B. Responses to FERC's Specific Inquiries

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)?

FERC has established a rebuttable presumption that a proposed transmission project satisfies Section 219(a) statutory threshold⁸ if such project: (i) results in a fair and open regional planning process that evaluates the project for reliability and congestion; or

⁸ Sec. 219 (a): RULEMAKING REQUIREMENT. –Not later than 1 year after the date of enactment of this section, the Commission shall establish, by rule, incentive-based (including performance-based) rate treatments 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.

(ii) has received approval from the appropriate state commission or state siting authority.

To satisfy Section 219(a), a project should meet both.

Until FERC has had the opportunity to establish measures to evaluate its incentive policies, the Ohio Commission agrees with FERC that there is no need to duplicate the process used to determine whether a project will benefit consumers. This is only true where the process includes input from all stakeholders and review from an independent party such as an RTO or ISO. However, not all projects approved through this process achieve both of the statutory standards set out in Section 219(a) and, as a result, are too costly for consumers. Consequently, the rebuttable presumptions established in Order No. 679 should not be applied to all projects that receive RTO or ISO Board approval. For the time being, the Ohio Commission recommends that all applicants be required to demonstrate that each project meets both requirements set out in Section 219(a). Therefore, all applicants should be required to participate in a fair and open regional planning process and receive approval from a state commission or siting authority before they receive rebuttable presumption protection under Section 219(a).

Order No. 679 Nexus Test

(Q25) In Order No. 679-A, the Commission state 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 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?

It is imperative for FERC to consider prior contractual obligations when considering project applications for transmission rate incentives. Providing incentives for

projects that are mandatory, due to prior contractual obligations, would not help accomplish the transmission infrastructure goals set out by Congress in the EAct of 2005.

Interrelationship of Incentives

(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 of CWIP and recovery of abandoned plant affect the evaluation of a request for an incentive ROE adder based on a project's risks and challenges?

There are mutable combinations of incentives that an applicant can seek.⁹ Each has the potential to influence another. For example, hypothetical capital structure can impact a higher ROE and CWIP could impact recovery of pre-commercial operating costs. The Ohio Commission recommends that each applicant should be required to provide a total incentive package evaluation so FERC can assess the potential impact each incentive may have on another.

The Ohio Commission also recommends that FERC cap incentives to the cost estimates provided in the applicant's original request. If the applicant's cost estimates turn out to be insufficient, the applicants should be provided an opportunity to re-apply and demonstrate why additional incentives are necessary and consistent with Sections 205 and 206. Automatically awarding additional money beyond projected CWIP could perversely incent companies to become less efficient because they would be rewarded for additional money expended, not for efficient behavior.

⁹ Incentives include 100 percent CWIP, accelerated depreciation, higher ROE, hypothetical capital structure, recovery of prudently incurred cost in cases of cancellation or abandonment, recovery of pre-commercial operating costs, deferred cost recovery, and any other incentive approved by FERC.

Incentive ROE Adder for Project Risks and Challenges

(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?

Transmission owners receive adequate compensation under the base ROE adder as determined by FERC. Increasing the ROE adder does not bolster investment in the nation's transmission infrastructure but it has the potential to degrade the benefits stated within Section 219. Although the ROE adder incentive is said to promote greater investment in new transmission by providing investors with greater returns, it will also reduce the benefits to consumers by raising their costs. Therefore, FERC should be required to demonstrate that perceived benefits exceed the cost of the requested incentive.

Abandonment

(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?

The current incentive, allowing recovery of 100 percent of prudently incurred abandoned plant costs, represents an inappropriate shift of risk from the project investors or developers to the customers. A 50/50 split in the recovery of prudently incurred plant costs would ensure that risk is shared proportionately between investors and customers.

Furthermore, to ensure that risks are appropriately allocated, recovery of abandoned plant costs should be inclusive of carrying charges and any ROE incentive should be included in the carrying charges to encourage future plant investment.

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?

A hypothetical capital structure allows an applicant to determine its overall rate of return for revenue requirement and ratemaking purposes based on a capital structure that is usually more heavily weighted towards equity financing than its actual, current capital structure. FERC stated that, under certain circumstances, the hypothetical capital structure incentive is appropriate for consideration because it fosters the development of transmission investment. In the past, FERC has done this primarily for startups, but has placed limitations on the incentive by requiring that the actual replace the hypothetical capital structure at some point, such as when a project commences operations. Since the periodic infusion of debt and equity capital during the construction phase will change the entities' capital structures, FERC has imposed restrictions on entities which request to use hypothetical capital structures for longer durations.

In most cases, FERC has supported the 50/50 capital structure. Any hypothetical capital structure resulting in equity greater than 50 percent should be approved rarely because higher allocating of equity to debt will result in higher rates to customers. However there is no "one-size-fits all" ratio which should be used. Thus, a debt to equity split beyond 50 percent would be more appropriately determined on a case-by-case basis. However, as a general practice, FERC should continue with its 50 percent allocation as a benchmark.

Applicants should minimally provide the following to support an application for a hypothetical capital structure: (1) the current capital structure; (2) changes to capital structure on a performance basis, on a semi-annual basis through the end of the project; (3) a credit profile of the company or its parent company; (4) details about the regulatory climate including zoning, siting and applicable EPA regulations; (5) a project funding profile; (6) construction program details; (7) project funding sources; (8) projected sources and uses of funds.

(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?

The actual capital structure for a new entity should match the hypothetical one at the commencement of the latter of construction or recovery, or accrual, of carrying costs on investment for its first project. For an established entity, the actual capital structure should match the hypothetical capital structure at the earlier of commencement of construction or recovery, or accrual, of carrying costs on investment. This provides the new entrants with sufficient time to obtain adequate financing and to reach final capitalization.

Pre-Commercial Cost Recovery

(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?

The incentive aspect of pre-commercial cost recovery allows applicants to expense and recover costs during the construction period. This improves project cash flows and

financial metrics, and mitigates the uncertainty over cost recovery of expenditures incurred prior to a project's regulatory approval and commercial operation. It does not appropriately balance the risks of transmission project development between utility applicants and customers. It does not balance at all, rather it simply shifts risk to customers. Incentive ROE adders are just that, an incentive for transmission project development. Applying ROE adders to carrying charges on deferred recovery of pre-commercial costs at the overall cost of capital, the risks associated with transmission projects are not shared by applicants and customers on an equitable basis. At a minimum, incentive ROE adders should not be applied to the regulatory asset created to recover deferred costs.

Additionally, the carrying charge should be based on the actual capital structure of the developer rather than the hypothetical capital structure used in the development phase of the project. The Ohio Commission maintains that 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.

Accelerated Depreciation

(Q) Which accounting methods should be used with a 15 year life?

FERC notes that accelerated depreciation is a regulatory incentive that allows an applicant to recover its return of capital costs more rapidly than under traditional regulatory treatment (e.g., 15 years or less). As a non-cash expense, accelerated depreciation may serve to enhance the applicant's cash flows and credit ratings.

The Sum-of-the-Years-Digits and the Declining Balance methods are accounting approaches designed to increase accruals in the early years of service life, while the

straight line depreciation method evenly allocates over each year. The straight line method has been the preferred choice in ratemaking because it will charge the ratepayer in each period a measure of the service life consumed during that period. However, the use of accelerated depreciation can be justified because the reduction in depreciation expense in later years is offset, to some extent, by an increase in maintenance. Thus, the accounting method should be decided on a case-by-case basis depending on the entity's needs and desires.

Advanced Technology

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

The Ohio Commission maintains that the guaranteed recovery of the cost incurred is the most effective incentive to encourage new advanced technology. However, the Ohio Commission believes that, in limited circumstances, a combination of project specific incentive ROE adders and accelerated depreciation of prudently incurred advanced technology costs would be effective.

CONCLUSION

FERC should not adopt policies that over compensate transmission providers. Consequently, FERC, among other things, should:

(1) allow both ROE adders and rate incentives only in very limited circumstances for projects involving advanced technologies and/or exceedingly high risk based on a set of predefined criteria;

(2) review its policies concerning ROE adders for RTO membership; and

(3) develop metrics to determine whether its transmission incentive policies are furthering Congress' goal to promote the construction of new transmission infrastructure to the ultimate benefit of consumers.

The Ohio Commission thanks FERC for the opportunity to file comments in this proceeding.

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On behalf of
The Public Utilities Commission of Ohio

CERTIFICATE OF SERVICE

I hereby certify that the foregoing have been served in accordance with 18 C.F.R. Sec. 385.2010 upon each person designated on the official service list compiled by the Secretary in this proceeding.

/s/ Thomas W. McNamee

Thomas W. McNamee

Dated at Columbus, Ohio this September 12, 2011.

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