

UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION

Promoting Transmission Investment  
Through Pricing Reform

Docket No. RM11-26-000

**COMMENTS OF CERTAIN STATE AND  
CONSUMER-OWNED ENTITIES**

In accordance with the Commission's Notice of Inquiry (NOI)<sup>1</sup> and its June 14, 2011, Notice of Extension of Time,<sup>2</sup> the undersigned entities<sup>3</sup> comment on the Commission's transmission-incentive regulations and policies under Order No. 679.<sup>4</sup>

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<sup>1</sup> *Promoting Transmission Investment Through Pricing Reform*, 135 FERC ¶ 61,146 (2011).

<sup>2</sup> Notice Extending Comment Period, *Promoting Transmission Investment Through Pricing Reform*, Docket No. RM11-26-000 (June 14, 2011), eLibrary No. 20110614-3004.

<sup>3</sup> The undersigned entities are: the Connecticut Public Utilities Regulatory Authority (CT PURA), which was formerly the Connecticut Department of Public Utility Control; George Jepsen, Attorney General for the State of Connecticut (CT AG); the Connecticut Office of Consumer Counsel (CT OCC); Joseph R. Biden, III, Attorney General for the State of Delaware (DE AG); the Delaware Public Service Commission (DE PSC); the Public Advocate of Delaware (DE Public Advocate); Lisa Madigan, Attorney General for the State of Illinois (IL AG); the Maine Public Utilities Commission (ME PUC); Martha Coakley, Attorney General for the Commonwealth of Massachusetts (MA AG); the Massachusetts Department of Public Utilities (MA DPU); the Massachusetts Municipal Wholesale Electric Company (MMWEC); the New England Conference of Public Utilities Commissioners (NECPUC); Michael A. Delaney, Attorney General for the State of New Hampshire (NH AG); the New Hampshire Electric Cooperative, Inc. (NHEC); the New Hampshire Office of Consumer Advocate (NH OCA); the New Hampshire Public Utilities Commission (NH PUC); the Rhode Island Public Utilities Commission (RI PUC) and Division of Public Utilities and Carriers (RI DPUC); Peter F. Kilmartin, Attorney General for the State of Rhode Island (RI AG); the Vermont Department of Public Service (VDPS); and the Vermont Public Service Board (VPSB).

The transmission incentive policies that are the subject of this NOI have been implemented with respect to Projects throughout the country, and have correspondingly broad impacts the Nation's consumers. These comments reflect support from advocates representing consumers in the Northeastern, Midwestern, and Middle Atlantic states.

<sup>4</sup> *Promoting Transmission Investment Through Pricing Reform*, Order No. 679, 71 Fed. Reg. 43,294 (July 31, 2006), FERC Stats. & Regs. ¶ 31,222 (2006), *on reh'g*, Order No. 679-A, 72 Fed. Reg. 1152 (Jan. 10, 2007), FERC Stats. & Regs. ¶ 31,236 (2006), *clarified*, 119 FERC ¶ 61,062 (2007).

## I. EXECUTIVE SUMMARY

The undersigned state agencies and consumer-owned utilities support the goals of Federal Power Act (FPA) section 219,<sup>5</sup> but have deep reservations about the manner in which that provision has been implemented. We therefore appreciate the Commission's decision to undertake this inquiry into its transmission-incentive rate policies. We encourage the Commission to modify its policies as described below, which will: (a) promote the construction of needed transmission; (b) reduce unnecessary costs imposed on consumers; and (c) free up ratepayer capital for other important electric-infrastructure investments.

As state regulatory commissions, state attorneys general, consumer advocates, and vertically-integrated load-serving entities (LSEs), we recognize the need for and the substantial consumer benefits of investments in new transmission facilities. In recent years, for example, New England has led the way in its commitment to investing in new transmission facilities. But New England consumers have been unfairly burdened by costly incentive rates added onto the already tremendous price tag for building those facilities—often in circumstances where the inducements were probably unnecessary and therefore wasteful.

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<sup>5</sup> Section 219 directed the Commission to “establish . . . 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.” 16 U.S.C. § 824s(a). Section 219 required the rule to “promote reliable and economically efficient” transmission and generation of electric energy. *Id.* § 824s(b)(1).

Nationwide, incentives granted under Order No. 679 to date will cost consumers half a billion dollars per year or more.<sup>6</sup> As many of these costs will continue for as long as the incentivized facilities are in rate base, the cumulative cost will be astronomical.

We have been especially troubled by the seemingly routine approval of return on equity (ROE) incentives even when those incentives appear not to be needed to induce new transmission construction. In New England, many circumstances reduce or eliminate the need for Order No. 679 ROE incentives, including: (a) regional transmission planning by a regional transmission operator (RTO); (b) cost recovery through formula rates, which decreases risk; (c) a bargained-for (and paid-for) commitment that the region's transmission owners will construct regionally-planned facilities, which often eliminates the need for further "incentives" for those facilities;<sup>7</sup> (d) abandoned-plant protections in the regional Transmission Operating Agreement<sup>8</sup> or granted by the Commission under

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<sup>6</sup> See Attachment A to Letter from Hon. Jon Wellinghoff, Chairman, Federal Energy Regulatory Commission, to Hon. Edward J. Markey, Chair, Subcommittee on Energy and Environment, U.S. House of Representatives (June 11, 2009), eLibrary No. 20090618-0125, estimating the "after tax" impact to utilities to be \$264 million per year. This after-tax figure understates the cost to consumers. Assuming a tax gross-up conversion factor of 1.67, the actual cost exceeds \$440 million per year. Moreover, this figure represents only the first-year annual cost of the return on equity (ROE) incentives that were granted under Order No. 679 prior to June 2009. It excludes the cost of other incentives issued under Order No. 679, such as the inclusion in rate base of 100 percent of construction work in progress (CWIP), and the cost of ROE incentives that have been granted since June 2009. It also excludes the cost of ROE incentives issued in prior orders, such as those provided to New England transmission owners under Opinion No. 489.

<sup>7</sup> See Schedule 3.09(a) § 1.1(a) of New England's Transmission Operating Agreement (TOA) (available at [http://www.iso-ne.com/regulatory/toa/v1\\_er07-1289-000\\_toa\\_composite.pdf](http://www.iso-ne.com/regulatory/toa/v1_er07-1289-000_toa_composite.pdf)). The region's consumers pay an additional 50 basis point return on the entire regional transmission rate base as an incentive awarded by the Commission to induce the region's transmission owners to join and remain part of the New England RTO arrangements that include the obligation to build.

<sup>8</sup> See TOA, *supra* n.7, Schedule 3.09(a) § 1.1(d).

Order No. 679; and (e) Commission approval of other, risk-reducing incentives such as inclusion in rate base of 100 percent of construction work in progress (CWIP) costs. Some or all of these factors are at work in other regions as well. Consideration of these factors should result in the prospective application of incentives to a narrower set of projects that truly require such incentives to facilitate development.

In implementing its transmission-incentive rate policy, the Commission's task should be to award only the least-costly incentive(s) that are shown to be necessary to promote needed and cost-effective transmission investment. Regardless of how beneficial a given transmission project may be, requiring consumers to pay more than necessary for it is always unjust and unreasonable. Authorizing public utilities to charge rates higher than necessary to induce the needed construction:

1. consumes ratepayer capital unnecessarily, sapping ratepayers' ability to pay for other important investments, including other transmission investments as well as investments in energy-efficiency or demand-response systems, renewable generation, or distribution-level upgrades, including smart grid technology; and
2. skews internal utility decision-making about whether to invest in transmission upgrades or in non-transmission measures, such as demand response or distributed generation, whose benefits might equal or exceed that of the transmission upgrade.<sup>9</sup>

Even worse, once embarked on, the policy of over-paying for transmission investment can be difficult to reverse. We are concerned that approval from the outset of overly-generous incentives or incentive packages has deprived the

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<sup>9</sup> This compounds any structural biases that favor transmission solutions within existing transmission-owner and RTO planning processes.

Commission of information with which to calibrate its incentive-rate policy. If one responds to potential illnesses not by diagnosing them methodically but by treating all possible illnesses, the patient's actual problems will not be diagnosed, effective treatments will not be identified, and over-medication will continue with all of its attendant costs and side effects.

The NOI's failure to include any data or analyses establishing a link between the awarding of specific incentives and improved performance is conspicuous, given that decisions applying Order No. 679 have committed consumers to paying hundreds of millions of dollars for ROE incentives and have made a point of obligating incentive-recipients to provide annual data regarding capital spending and project status. To the extent a project is not on schedule, the recipient is required to explain why that is the case. *See* FERC Form 730. Yet the NOI neither reviews that data nor attempts to draw any conclusions from it. In fact, we have found no public tabulation or analysis (in the NOI or elsewhere) of the transmission incentive applications received, the numbers and types of incentives that have been granted, the presence or absence of various factors that affect transmission development (e.g., whether a project was planned through an RTO, whether project costs will be recovered using formula rates, or whether investment partners were sought). And while the Commission requires incentive-recipients to submit data regarding their project's construction status, including whether it is on schedule and within budget, we are aware of no public compilation of that data or any attempt to correlate the receipt of incentives with the recipients' performance in constructing the incentivized projects. Instead, the

NOI asks the industry for comments on how the Commission's incentive policy has affected transmission investment.

The question is difficult to answer credibly (in part because of how the policy has been structured and implemented), but rigorous review remains important lest the data be misinterpreted. Transmission investment indisputably has increased since Order No. 679 was issued, and incentive-recipients likely will attribute the increase to the Commission's incentive policy. But transmission investment already was increasing when the Commission issued Order No. 679, and causes other than rate incentives—including (but not limited to) the advent of regional transmission planning by RTOs, the development and enforcement of mandatory reliability standards by NERC and this Commission, and a greater focus on the need to integrate renewable resources—may have prompted much of that investment. And to the extent that certain incentives may have been instrumental in some cases, the routine approval of incentive packages inhibits assessment of which incentives were needed and which were windfalls.

The issuance of the NOI represents an important opportunity for the Commission to refine its transmission-incentive policy by establishing criteria that focus on risk mitigation and containing costs to consumers. We encourage the Commission to:

1. Define a baseline level of performance and investment that the Commission expects of all transmission-owning public utilities, for which the transmission owners are compensated by the base ROE (including any RTO-participation incentive), and provide a more thorough, objective explanation of which transmission investments it will consider "routine."

2. Treat as presumptively ineligible for incentives (or at least ineligible for ROE adders) projects encompassed within that baseline, including, at minimum, facilities that are designed to achieve compliance with mandatory reliability standards or that the applicant is otherwise required to construct (e.g. because of merger-approval conditions or conditions undertaken upon joining an RTO).
3. Require incentive applicants to demonstrate that they have engaged in reasonable efforts to mitigate the project risks, including but not limited to seeking investment partners, prior to requesting incentives.
4. If incentives are shown to be needed, award the least costly, risk-reducing incentives first, such as CWIP and/or abandoned-plant recovery, and require increasingly rigorous showings of need before granting requests for more costly incentives such as ROE adders.
5. Establish a transparent, objective framework for determining the level of ROE incentive to be granted (if any), based on (a) the degree to which the risk of investment loss exceeds the level of risk that is compensated by the base ROE, or (b) a demonstration that the use of advanced or innovative technologies or practices will produce consumer benefits exceeding the incremental costs (including that of the ROE incentive) of using those technologies or practices.<sup>10</sup>
6. Impose a higher evidentiary burden on applicants seeking ROE incentives where (a) the transmission investment at issue will be recovered under formula rates or (b) the ROE would be in addition to risk-reducing incentives, such as (i) rate base recovery of 100 percent of CWIP or (ii) the ability to seek recovery of investment in facilities that are abandoned for reasons outside the applicant's control.

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<sup>10</sup> In considering ROE incentives for the use of advanced or innovative technologies or practices that produce net consumer benefits, the Commission still must take care to avoid granting windfalls for activities that the transmission owner is obligated to undertake. In some cases, the use of advanced or innovative technologies or practices may be the only effective way in which to gain siting approval of, or otherwise to complete, a project that the transmission owner is obligated to build.

7. Refrain from applying ROE adders to CWIP and abandoned plant amounts.<sup>11</sup>
8. Comply with Congress's instruction to consider performance-based incentives by (a) applying the ROE adder only to budgeted project costs, not cost overruns; and (b) phasing out any ROE adder if the project is not completed on time and within budget.

We look forward to the Commission's consideration of these comments, and hope that the Commission will refine its policy to take a more cost-effective approach to developing a modern, robust transmission system. While certain incentives may be warranted in some cases, consumers must not be required to fund costly incentives for projects that transmission owners would build in the ordinary course of business. As the Commission ruled nearly a decade ago, the public interest is not served by rewarding a transmission owner "for doing what it is supposed to do, *i.e.*, to adequately maintain its facilities in a prudent, cost-effective manner."<sup>12</sup>

## II. INTERESTS OF SIGNATORIES

The **CT PURA**, formerly the Connecticut Department of Public Utility Control, is the state public utility commission responsible for all matters of rate regulation for public utilities and regulated entities under title 16 of the Connecticut General Statutes. The CT PURA, like this Commission, is charged with promoting policies that will lead to just and reasonable utility rates. The CT

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<sup>11</sup> While it may be useful to protect applicants against risks of loss in order to promote the construction of new transmission, applicants should not be indifferent to whether projects actually enter service. They should have incentives to complete their projects so that they serve consumers. Thus, ROE adders should apply only to projects that have entered service, thereby rewarding only outcomes rather than attempts.

<sup>12</sup> *New England Power Pool*, 97 FERC ¶ 61,093, at 61,477 (2001) (*NEPOOL*).

PURA also is charged with ensuring that there is adequate and reliable electricity service in Connecticut.

The **CT AG** is an elected Constitutional official and the chief legal officer of the State of Connecticut. Among the CT AG's responsibilities are interventions in various types of proceedings to protect the State, the public interest and the people of the State of Connecticut, and assuring the enforcement of a variety of laws of the State of Connecticut, including Connecticut's Unfair Trade Practices Act and Antitrust Act, so as to promote the benefits of competition and to assure the protection of Connecticut's consumers from anti-competitive abuses.

The **CT OCC** is an independent agency of the State of Connecticut with statutory responsibility to represent customers of Connecticut's five regulated utilities, including electric utilities. CT OCC seeks to ensure just and reasonable rates and reliable utility service for customers of Connecticut's electric utilities and to promote beneficial policies for ratepayers.

The **DE AG** is the chief law officer of the State of Delaware. In that capacity, the DE AG represents the interests of the public and exercises broad powers under the common law. *See Darling Apt. Co. v. Springer*, 22 A.2d 397, 433 (Del. Ch. 1941).

The **DE PSC** is an agency in the State of Delaware, organized and existing by virtue of the statutes enacted by the Delaware General Assembly, and charged with responsibility to supervise and regulate all Delaware public utilities (including electric companies) to ensure their operation in the interest of the

public and to promote adequate, economical and efficient delivery of utility services in the State.

The **DE Public Advocate** is authorized and directed by 29 Del. C. Sec. 8716(3) “[t]o appear on behalf of the interest of consumers in the courts of this State, the federal courts and federal administrative and regulatory agencies and commissions in matters involving rates, service and practices of public utilities.”

The **IL AG** represents the People of the State of Illinois on public utility issues in proceedings before the Illinois Commerce Commission, federal regulatory agencies and state and federal courts. The Attorney General has authority “to protect the rights and interests of the public in the provision of all elements of electric . . . service both during and after the transition to a competitive market, and . . . to ensure that the benefits of competition in the provision of electric . . . services to all consumers are attained . . .” 15 ILCS 205/6.5.

The **ME PUC** is the state commission designated by statute with jurisdiction over rates and service of electric utilities in the state. *See* Me. Rev. Stat. Ann. tit. 35-A § 101 *et seq.* The Commission regulates electric utilities to ensure that Maine consumers enjoy safe, adequate and reliable services at rates that are just and reasonable for both consumers and utilities.

The **MA AG** is the chief lawyer and law enforcement officer of the Commonwealth of Massachusetts, charged with (*inter alia*) representing the Commonwealth, the public interest, and the people of the Commonwealth with

respect to electric or gas industry matters that affect electric or gas consumers in Massachusetts.

The **MA DPU** is the agency of the Commonwealth of Massachusetts charged with general regulatory supervision over gas and electric companies in Massachusetts, with jurisdiction to regulate rates or charges for the sale of electric energy and natural gas to consumers. Mass. Gen. Laws ch. 164, § 76 *et seq.* Its mission includes ensuring that the Commonwealth's utility consumers are provided with the most reliable service at the lowest possible cost.

**MMWEC** is a political subdivision of the Commonwealth of Massachusetts and a Participant in the New England Power Pool (NEPOOL) engaged, *inter alia*, in the procurement and development of bulk power supply resources for its twenty (20) municipally-owned electric system members and others. *See* Mass. St. 1975, c. 775. MMWEC and its members purchase regional network transmission service under the ISO-NE OATT.

**NECPUC** is a not-for-profit corporation comprised of all the public utilities commissioners of the States of Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island and Vermont. Formed over sixty years ago and funded by the New England states, NECPUC's mission is the promotion of regional cooperation and effective communication on all public utility matters within New England.

The **NH AG** is New Hampshire's chief legal officer and chief law enforcement officer. The NH AG acts as the State's lawyer in all civil and

criminal cases in the Supreme Court, and is responsible for the general supervision of all criminal law enforcement in the State of New Hampshire.

**NHEC** is a consumer-owned electric distribution cooperative that provides retail electric distribution service to its more than 80,000 member consumer accounts located in nine of New Hampshire's ten counties. NHEC is an active participant in the New England wholesale power markets, and is a NEPOOL Participant and load serving entity of long-standing. NHEC takes transmission service under open access transmission tariff arrangements in place in New England.

The **NH OCA** is an independent agency of the State of New Hampshire charged by NH RSA 363:28 with representing the interests of residential ratepayers of New Hampshire's regulated utilities, including the state's electric utilities. The NH OCA advocates for safe and reliable service at just and reasonable rates, and for other policies that protect and provide benefits to ratepayers.

The **NH PUC** is the state agency charged under New Hampshire law with the "general supervision of all public utilities" in the state. N.H. Rev. Stat. Ann. §§ 362:2 & 374:3. The NHPUC is also empowered to confer or cooperate with other state and federal agencies on matters relating to its supervision of utilities. *Id.* § 363:18.

The **RI PUC** and **RI DPUC** regulate the conduct of electric utilities in the state for the purposes (*inter alia*) of increasing and maintaining the efficiency of such companies and protecting the public against improper and unreasonable

rates, tolls, charges. R.I. Gen. Laws §§ 39-1-1(c) & 39-1-19(b). The RI DPUC is statutorily mandated to represent the interests of Rhode Island consumers in proceedings before this Commission, including specifically those affecting or relating to regional transmission issues. R.I. Gen. Laws § 39-1-29.

The **RI AG** is, pursuant to § 42-9-6 of the General Laws of Rhode Island of 1956, as amended, the “legal advisor . . . of all state boards, divisions, departments, and commissions and the officers thereof . . .” Under the common law, he is the representative of the public, empowered to bring actions to redress grievances suffered by the public as a whole. He is also the statutory legal representative of the RI DPUC.

The **VDPS** is charged, through the Director for Public Advocacy, to represent the interests of the public in utility matters before the Vermont Public Service Board as well as before the Commission. *See* Vt. Stat. Ann. tit. 30, § 2(b). As the State of Vermont’s public advocate, VDPS has an affirmative duty to protect the interests of Vermont consumers of electricity in securing reliable, safe, reasonably priced power.

The **VPSB** is a quasi-judicial board that supervises the rates, quality of service, and overall financial management of Vermont’s public utilities. The VPSB’s mission is to ensure the provision of high-quality public utility services in Vermont at minimum reasonable costs, measured over time periods consistent with the long-term public good of the state. The VPSB strives to achieve this mission by (*inter alia*) guiding the development of state utility policies and rules

for public services to best serve the long-term interest of Vermont and its residents, all as defined in title 30 of the Vermont Annotated Statutes.

### III. COMMUNICATIONS

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#### **IV. COMMENTS**

It is important to develop and maintain a modern, robust electric transmission system, but the broad application of overly generous transmission-rate incentives has imposed unwarranted and excessive charges on consumers. No matter how beneficial transmission investment may be in general or a specific project may be in particular, requiring consumers to pay more than necessary to induce that investment is never in the public interest.

We welcome the Commission's inquiry into potential refinements of its policy, and encourage the Commission to modify its incentive policy as set forth

below. The comments below address the NOI's "overarching" and policy-framework questions, touching where necessary on the use of individual incentives. We address more particular questions about individual incentives in the attached Appendix.

**A. *Comments on "overarching questions": The benefits of most transmission-rate incentives are unproven, while the costs are concrete and substantial.***

The NOI begins (P 15) by asking "overarching questions" about the transmission-incentive policy under Order No. 679.

1. The effects of existing Order No. 679 policies cannot be evaluated confidently, because correlation is not causation and the application of these policies has not been methodical.

The NOI asks how the existing policies under Order No. 679 have affected transmission-investment patterns and consumer rates and services.<sup>13</sup> That the NOI poses these questions without even a tentative analysis of the data available, via Form 730 and otherwise, is telling. The questions are difficult to answer empirically, in part because of the way in which the policies were developed and implemented. Nonetheless, rigorous analysis of the available data is important, because failing to undertake it increases the risk that the Commission will

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<sup>13</sup> For example, the Commission asks: "(1) What have been the effects of the incentives policies adopted in Order No. 679 with respect to the goals set forth in section 219? (2) Are the Commission's incentives policies appropriately promoting investment in transmission infrastructure in accordance with section 219? . . . (7) 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? (8) Have the incentives granted to transmission projects had an impact on investment patterns in the electricity industry? Do the incentives impact the allocation of investment capital among transmission, generation, and distribution facilities?"

continue to pursue or will adopt new incentive policies based on misinterpretations of the facts.

We expect the recipients of transmission-rate incentives to point to increased levels of transmission investment in recent years and to claim that the incentives induced the investments. But correlation is not causation. It is true that the pace of transmission investment has quickened in recent years—dramatically so in New England—but the uptick cannot be attributed confidently to the receipt of incentives. To the contrary, if other developments would have produced the same increased investment, the rate incentives were unneeded and resulted in customers paying more than necessary for new investment.

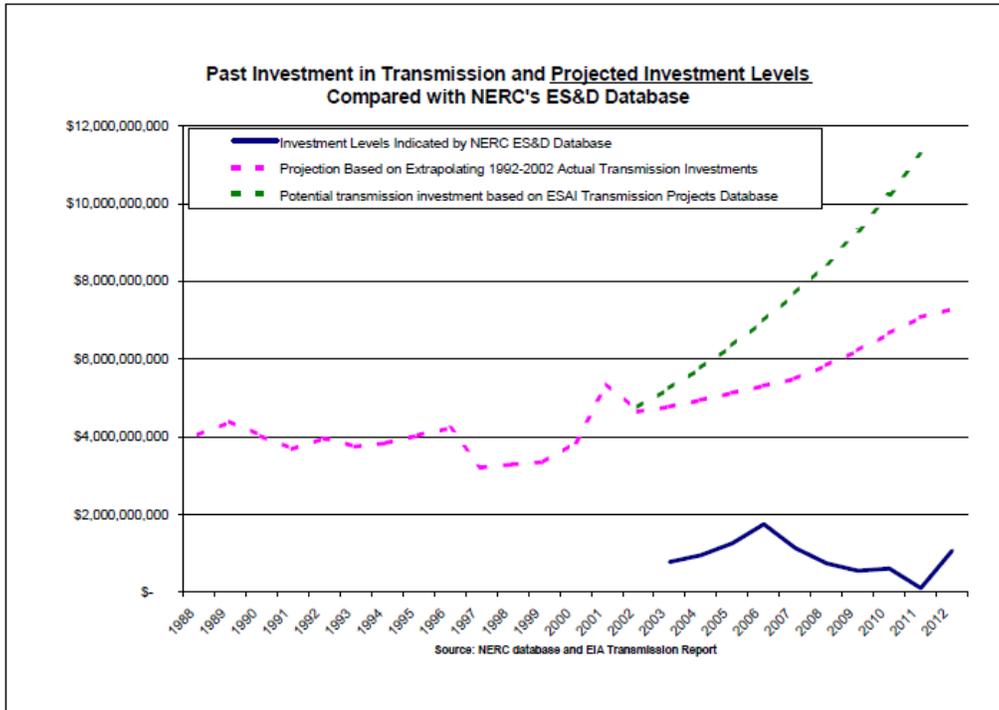
One must view skeptically claims that incentives led to investment that otherwise would not have occurred, as the data show that investment *already* was increasing before the Commission issued Order No. 679. For example, the Edison Electric Institute’s 2005 Survey of Transmission Investment<sup>14</sup> found that “the industry [had] reversed a long-standing downward trend in transmission investment.” *Id.* at 3. It observed that “transmission investment, in constant dollars, declined from 1975 through 1998,” but “has been increasing since 1999.” *Id.* From 1999 to 2003, transmission investment increased at a “robust” 12 percent annual rate. *Id.* EEI noted that planned investment for 2004-2008 was 62 percent of 2003 net book value, reaching “levels not seen in nearly 30 years.” *Id.* at 5.<sup>15</sup>

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<sup>14</sup> EEI Survey of Transmission, Investment Historical and Planned Capital Expenditures (1999-2008), Edison Electric Institute (May 2005) (*available at* [http://www.eei.org/ourissues/ElectricityTransmission/Documents/Trans\\_Survey\\_Web.pdf](http://www.eei.org/ourissues/ElectricityTransmission/Documents/Trans_Survey_Web.pdf)).

<sup>15</sup> On average, only 6.5 percent of the planned investment was devoted to generator interconnection, while the remainder would consist of network upgrades that “improve

EEI's July 2005 report, "Meeting U.S. Transmission Needs,"<sup>16</sup> similarly projected substantial increases in transmission investment over the ensuing years:



EEI explained that “[s]imple extrapolation of historic data [represented by the pink dotted line] indicates transmission investment levels of \$5 billion per year rising to \$7 billion per year over the next decade,” but more detailed review of then-existing transmission expansion plans suggested that “the pace of transmission investment [represented by the steeper green dotted line] will be even higher, rising to the \$10 billion and more per year level shown in the chart above.” *Id.* at vii.

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transfer capability between regions, improve grid reliability, and enhance local, regional, and inter-regional markets.” *Id.*

<sup>16</sup> Available at [http://www.eei.org/ourissues/ElectricityTransmission/Documents/meeting\\_trans\\_needs.pdf](http://www.eei.org/ourissues/ElectricityTransmission/Documents/meeting_trans_needs.pdf).

EEI attributed the increase to several factors, including “[r]egional transmission expansion planning by ISOs and RTOs[, which] has put into play a process that compels the building-out of their transmission systems to maintain reliability across larger and larger market footprints.” *Id.* EEI also pointed to “[t]he slowdown in merchant generation investment[] and a growing desire to diversify the generation portfolio (or maintain a diversified portfolio),” which EEI said were “causing utilities and their state regulators to re-evaluate the role of transmission in bringing wind, coal, and hydro resources into the generation mix.” *Id.* Given such pre-existing trends and predictions, one may not assume that post-Order No. 679 transmission-investment jumps resulted substantially or at all from the Commission’s incentive-rate policies. In fact, as of July 2005, ISO New England’s Regional System Plan already included transmission projects then estimated to cost more than \$3 billion.<sup>17</sup>

Even if actual investment surpassed pre-Order No. 679 expectations, one could not attribute it confidently to the Commission’s incentive-rate policies. The same legislation that enacted FPA section 219 also set in motion other developments—including the adoption of mandatory reliability standards—that contributed to the renewed focus on transmission investment. EEI’s March 2011 “Transmission Projects: At a Glance” report noted that “[m]any of the projects in this report have an initial driver to maintain the reliability of the transmission system and meet NERC Reliability Standards (*e.g.*, the Transmission Planning

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<sup>17</sup> See July ’05 ISO-New England Project Listing Update (Final), ISO New England, Inc. (July 29, 2005) (*available at* [http://www.iso-ne.com/trans/rsp/2005/july05\\_iso\\_ne\\_project\\_listing\\_072105.xls](http://www.iso-ne.com/trans/rsp/2005/july05_iso_ne_project_listing_072105.xls)).

TPL standards) or Transmission Owner reliability criteria.”<sup>18</sup> As EEI explained, “*these projects are required to maintain the operational integrity of the interconnected Bulk Electric System and are required to be constructed.*” *Id.* (emphasis added). EEI estimated that mandatory, reliability-related projects constituted 25 percent of the transmission investment discussed in the report.<sup>19</sup> In New England, whether driven by the adoption of mandatory reliability standards or simply by good utility practice, reliability needs have formed the basis for virtually all of the new regional transmission facilities planned and constructed since 2005.

Subsequent federal and state developments besides the advent of mandatory reliability standards also have played a role in spurring transmission investment. The issuance of Order No. 890 and its progeny encouraged the evolution of transmission-planning processes in both RTO and non-RTO regions. At the same time, the development of state renewable portfolio standards (RPS), the possibility of a federal standard, and the prospect of EPA regulations forcing retirement of tens of gigawatts of electric generating capacity,<sup>20</sup> all have

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<sup>18</sup> Transmission Projects: At A Glance at xi, Edison Electric Institute (Mar. 2011) (*available at* [http://www.eei.org/ourissues/ElectricityTransmission/Documents/Trans\\_Project\\_intro.pdf](http://www.eei.org/ourissues/ElectricityTransmission/Documents/Trans_Project_intro.pdf)).

<sup>19</sup> *Id.* at xii. Because the report only covered large-scale projects that the transmission owners chose to highlight, *id.* at iii, the reliability-driven percentage of *total* transmission investment, including smaller-scale projects, is likely even higher.

<sup>20</sup> *See, e.g.*, Coal Capacity at Risk for Retirement in PJM: Potential Impacts of the Finalized EPA Cross State Air Pollution Rule and Proposed National Emissions Standards for Hazardous Air Pollutants, PJM Interconnection, LLC (Aug. 26, 2011) (*available at* <http://pjm.com/~media/documents/reports/20110826-coal-capacity-at-risk-for-retirement.ashx>); Abby Gruen, *Economic hit from EPA pollution rules changing energy landscape*, SNL, (July 29, 2011) (*available at* <http://www.snl.com/InteractiveX/article.aspx?ID=13099796>) (reviewing additional studies); Strategic Planning Issues slide 8, ISO New England, Inc. (Mar. 4, 2011) (*available at* <http://goo.gl/PbDDO>) (describing retirement pressures on coal, oil, and nuclear resources).

emphasized the need for new transmission to accommodate changing generation topology.<sup>21</sup> Finally, the 2008 financial crisis and ensuing recession affected the financial climate in ways that make investments in regulated, cost-of-service projects more attractive.

While independent factors have been at work to promote transmission construction both before and after Order No. 679 was issued, making it difficult to assess empirically whether incentives spur investment, the design and implementation of the Order No. 679 transmission-incentive policy has magnified the difficulty in analyzing the impact of incentives on transmission development. When ISO New England, Inc. became the RTO for the region, the Commission approved several mechanisms designed to promote transmission construction: (1) a contract requiring the region's transmission owners to construct facilities that are included in ISO-NE's regional system plan and providing abandoned-plant protections;<sup>22</sup> (2) an 11.14 percent base ROE plus a 50-basis point, RTO-participation adder; and (3) a 100-basis point ROE adder on investments in new, regionally-planned facilities.<sup>23</sup> Because the Commission authorized the 100-basis

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<sup>21</sup> According to EEI's 2009 "Transmission: At a Glance," "[h]ighlighted projects that facilitate the integration of renewable resources reflect the addition or upgrade of 11,400 miles of transmission with an accompanying transmission investment cost of approximately \$39.5 billion (nominal dollars)." *Id.* at x. That investment amount corresponded to 65 percent of the total investment amount discussed in the report. *Id.* at xi.

<sup>22</sup> In return for joining the RTO and agreeing to the commitment to construct, each TO was granted, among other things, a 50-basis point ROE adder applicable to its entire transmission rate base, including both pre-RTO and post-RTO investment.

<sup>23</sup> *Bangor Hydro-Electric Co.*, 117 FERC ¶ 61,129 (2006) (Opinion No. 489), *order on reh'g*, 122 FERC ¶ 61,265, P 51 (2008) (phasing out Opinion No. 489's pre-approved incentive authorization in favor of Order No. 679's case-by-case approach for projects completed after December 31, 2008), *aff'd sub nom. Conn. Dept. of Pub. Util. Control v. FERC*, 569 F.3d 477 (D. C. Cir. 2009). To our knowledge, no party objected to replacement of the Opinion No. 489 incentive with Order No. 679's case-by-case approach on grounds that the 100-basis

point incentive at the same time that it accepted the RTO arrangements including the commitment to construct, it is impossible to assess whether the construction commitment, the TOA-based abandoned-plant protection, and the 11.64 percent base-plus-RTO-participation ROE would have induced investment without the additional 100-point adder. Likewise, the post-Order No. 679 practice of approving ROE incentives simultaneously with risk-reducing CWIP and abandoned-plant incentives makes it difficult to determine which incentives may have been needed and which were merely windfalls to the recipients.

Although it is impossible to trace the benefits of transmission construction to the use of rate incentives,<sup>24</sup> the consumer costs of rate incentives—particularly ROE adders—are concrete and substantial. In June 2009, Chairman Wellinghoff responded to an inquiry from Representative Edward J. Markey regarding the Commission’s incentive-rate policy, and provided data regarding the incentives the Commission had awarded up to that point. As of June 2009, the Commission had approved Order No. 679 incentives for 58 transmission projects, of which “50 projects received some form of ROE incentive, often together with other incentives.”<sup>25</sup> The weighted average ROE adder was 130 basis points. *Id.* at 2-3. The range of ROE adders varied from 0 to 260 basis points. *Id.*, Attachment A.

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point Opinion No. 489 ROE adder was an essential part of the bargain inducing the transmission owners to join or to remain in the New England RTO. Certainly, no TO withdrew from New England’s RTO arrangements when the phase-out occurred.

<sup>24</sup> As explained below, the likelihood of a causal connection between ROE adders and new construction is especially tenuous.

<sup>25</sup> Letter from Hon. Jon Wellinghoff, *supra*, n.6, at 2.

If all of the projects were completed as planned at their projected costs and if all had 50/50 capital structures, Chairman Wellinghoff explained that the aggregate “financial value of these ROE adders to the utilities would be approximately \$264 million, after tax,” for the first 12-month period of each project. *Id.* at 3 & n.6. Because consumers also compensate utilities for the taxes they pay on equity returns, the corresponding cost to consumers is even greater. And while the annual amount would decrease over time as the facilities depreciated, the ROE incentives would continue to be applied to any undepreciated investment for the entire useful life of the facilities—typically 30 years or more. The cumulative tax on consumers’ checkbooks is therefore astronomical, even assuming (contrary to most evidence) that most projects actually would be completed at their projected costs. In fact, in recent years, actual project costs often have exceeded budgeted amounts by 100% or more.<sup>26</sup> And since June 2009, applicants have requested and the Commission has granted substantial additional ROE incentives for newly proposed projects.<sup>27</sup> Between June 2009 and May 2011, at least 17 new transmission-incentive applications were filed.<sup>28</sup>

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<sup>26</sup> See, e.g., Complaint of the New England Conference of Public Utilities Commissioners, Inc., Seeking Limitation on Amount of Transmission Costs to Which Incentive ROE Adder Applies at 9-11, *New England Conference of Pub. Util. Comm’rs, Inc. v. Bangor Hydro-Electric Co.*, Docket No. EL08-69-000 (June 12, 2008), eLibrary No. 20080612-5116 (NECPUC Complaint) (listing examples).

<sup>27</sup> We are not aware of any current compilation comparable to the statistics provided in Chairman Wellinghoff’s letter to Rep. Markey. Maintaining such a compilation would improve the transparency of the Commission’s transmission-incentive program and would facilitate efforts to refine that program over time.

<sup>28</sup> Compare Chairman Wellinghoff’s letter, *supra* n.7, describing applications for 58 projects, with NOI P 1, noting that “[i]n the past five years, the Commission has received over 75 applications for transmission incentives.” It is not clear whether the “58 projects” and “75

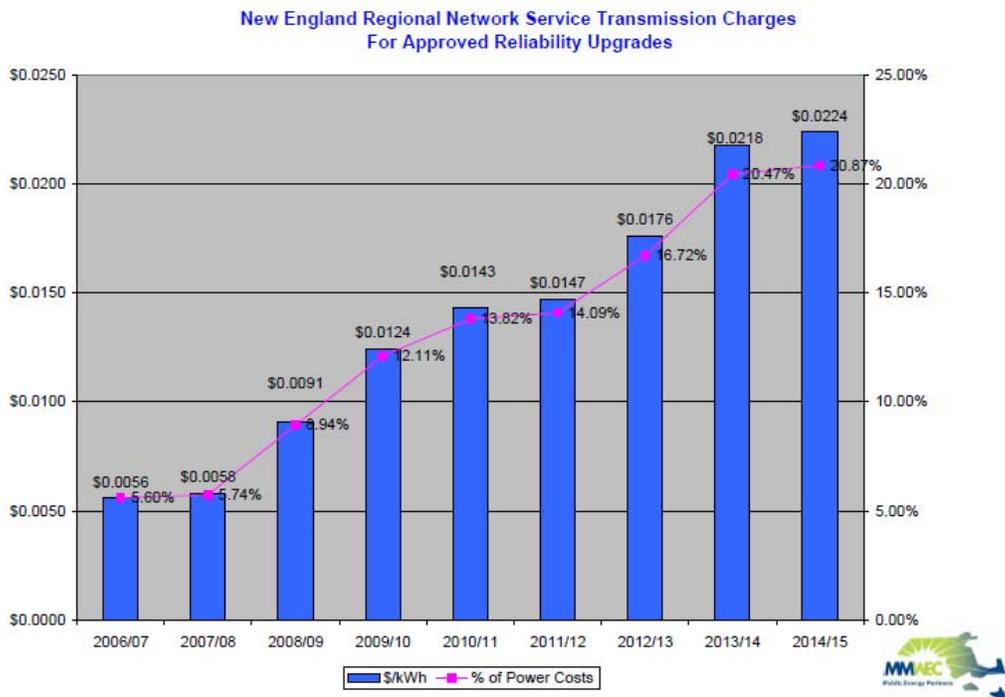
In New England, Order No. 679 ROE incentives have contributed significantly to fast-rising transmission rates, while playing a questionable role in spurring new construction. As of June 2009, according to Chairman Wellinghoff's letter to Rep. Markey, the Order No. 679 ROE incentives associated with New England transmission projects carried a first-year cost of nearly \$30 million. These annual incentive amounts are on top of an already-generous 11.14 percent base ROE, the 50-basis point RTO-participation adder applied to all New England transmission in rate base, the 100-basis point adders and abandoned-plant protection that were granted under Opinion No. 489, and the cost of other incentives (such as CWIP in rate base) that have been granted under Order No. 679.

We have neither found nor been able to develop a comprehensive assessment of the cost of these incentives to New England consumers, but the combined effect of increased transmission investment in New England, the generous base ROE and RTO-participation bonus, and the other ROE incentives granted under Opinion No. 489 and Order No. 679, has been to increase the transmission portion of New England consumers' bills substantially. Between now and 2015, New England consumers are expected to see their transmission costs double, based *only* on the estimated costs of projects that are needed for reliability and included in ISO New England's Regional System Plan (RSP)—projects that the region's Transmission Owners are obligated to build. As noted above, project

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applications" are comparable figures or whether an application may cover more than one project.

cost estimates often fall well short of actual project costs, yet even the estimated investments in such facilities will increase the regional transmission rate base from \$3.8 billion in 2010 to more than \$9 billion in 2015. MMWEC, one of the undersigned load-serving entities, estimates that as a percentage of total power costs, transmission costs will have increased from less than 6% in 2008 to approximately 21% in 2014:



We recognize that the above-quoted costs (and resulting rate impacts) represent far more than simply the Order No. 679 incentives. They include recovery of the TOs' investment as well as the 11.14 percent base ROE, the 50-basis point RTO-participation adder, the Opinion No. 489 adders, and any Order No. 679 adders. The point, however, is that both transmission investment

and transmission rates are skyrocketing in New England.<sup>29</sup> While we do not necessarily challenge the need for new investment or its potential benefits in appropriate cases, it remains especially important to refrain from adding to consumers' burdens by awarding unnecessary incentives.

2. Comments on "balance[ing] the promotion of transmission investment with the assurance of just and reasonable rates": The Commission should identify the least-cost incentives and award them only on appropriate showings of need.

The NOI asks how the Commission should "best balance the promotion of transmission investment with the assurance of just and reasonable rates?"<sup>30</sup> To date, the Commission has attempted to achieve this balance by articulating highly general standards that it has sought to apply to individual cases. We submit that it has been difficult to discern the bases for the decisions reached using this approach, including decisions to grant ROE adders of various levels, up to 275 basis points in some cases.<sup>31</sup>

We encourage the Commission to consider changing the standards used to evaluate incentive-rate applications, making them more rigorous and transparent. Most importantly, we believe the Commission should focus on: (a) identifying the least-cost, least-disruptive incentives that will be effective in promoting

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<sup>29</sup> Because of the magnitude of recent transmission investment and its effect in reducing transmission congestion, ISO-NE's external market monitor, Dr. David Patton, recently observed that it was "surprising that anyone was thinking of building transmission for the foreseeable future for economic reasons [as opposed to reliability reasons] and urged caution in adopting planning criteria that would lead to investing in uneconomic transmission." Minutes of July 13, 2011 Meeting at 2561, New England Power Pool Participants (Aug. 25, 2011) (*available at* <http://goo.gl/SPKa3>).

<sup>30</sup> NOI P 15, question 9.

<sup>31</sup> *E.g., N.Y. Reg'l Interconnect, Inc.*, 124 FERC ¶ 61,259, P 2 (2008).

transmission investment; and (b) awarding those incentives only when they are shown to be needed to induce investment. In advancing this position, we are not advocating for the adoption of a but-for test; nor are we suggesting that incentive-applicants be required to prove a negative.<sup>32</sup> Instead, we suggest that the Commission adopt a more rigorous, objective, and calibrated approach to awarding transmission incentives.

Specifically, and as explained below, the Commission should establish a presumption against providing rate incentives for investments that transmission owners are required to make (e.g., to comply with reliability requirements or because of contractual commitments). Where that presumption does not apply or is rebutted, the Commission should award the least costly incentive it determines to be necessary to induce the investment. We acknowledge that this standard is easier to articulate than to implement, but a rule of thumb should help: the Commission should grant risk-reducing incentives such as CWIP or abandoned-plant recovery only when necessary and before considering any ROE adder. The combination of the CWIP incentive (which addresses cash-flow concerns during construction) and the abandoned-plant incentive (which addresses concern that project investors could act prudently but fail to complete the project and recover their sunk costs) should go far toward mitigating risk and promoting investment. That is especially true where, as in New England, investment recovery is under a formula rate.

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<sup>32</sup> That is, we do not claim that incentive-applicants should be required to demonstrate that they would not invest in particular transmission facilities absent an incentive.

ROE incentives should be reserved for: (a) the rare cases in which, after the applicant has taken reasonable measures to mitigate its risk and after the risk-reducing effects of other incentives are accounted for, the remaining risks are demonstrable and exceed those that are already compensated by the base ROE;<sup>33</sup> or (b) instances in which a transmission project uses advanced or innovative technologies or practices that will yield tangible consumer benefits outweighing their incremental costs (including that of the ROE incentive). Where ROE incentives are awarded, the Commission should ensure that the incentives are performance-based (as required by FPA section 219), so that consumers can be assured of receiving fair value in return for their incentive payments.<sup>34</sup>

***B. Comments on the “[s]ection 219(a) statutory threshold”:  
To satisfy section 219, the Commission should focus on  
ensuring that transmission investment is cost-effective.***

FPA section 219(a) required the Commission to establish “incentive-based (including performance-based) rate treatments . . . for the purpose of benefitting consumers by ensuring reliability and reducing the cost of delivered power by reducing transmission congestion.” 16 U.S.C. § 824s(a). Order No. 679 (Subpart

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<sup>33</sup> Base ROEs traditionally are established by determining the implied cost of equity of—i.e., the return necessary to induce investment in—a utility of average risk in a proxy group of comparable companies. *E.g.*, *Portland Natural Gas Transmission Sys.*, 134 FERC ¶ 61,129, P 265 (2011) (“The Commission’s traditional assumption with regard to relative risk is that pipelines generally fall into a broad range of average risk absent highly unusual circumstances that indicate an anomalously high or low risk as compared to other pipelines.”) In other cases, where the Commission sets a single base ROE to apply to a “broad group of utilities with diverse risks and business profiles,” the Commission has stated that it considers the group’s “full range of risks and business profiles” in establishing the base ROE. *Midwest Indep. Transmission Sys. Op., Inc.*, 106 FERC ¶ 61,302, P 9 (2004), *aff’d sub nom. Pub. Serv. Comm’n of Ky. v. FERC*, 397 F.3d 1004, 1010 (D.C. Cir. 2005).

<sup>34</sup> See Section IV.F, explaining that, when incentives are granted, the Commission should tailor them to encourage the construction of new transmission facilities on schedule and within budget.

G § 35.35(i)(1)) established a rebuttable presumption that a project satisfies these objectives if it: “(1) results from a fair and open regional planning process that considers and evaluates projects for reliability and/or congestion and is found to be acceptable to the Commission;” or “(2) . . . has received construction approval from an appropriate state commission or state siting authority.” Alternatively, an applicant can show independently “that its project either ensures reliability or reduces transmission congestion and therefore is eligible for incentives.” NOI P 16. The NOI asks whether the rebuttable presumptions are appropriate bases for satisfying the statutory threshold, whether other criteria should be adopted as rebuttable presumptions, and what data the Commission should consider in evaluating independent showings.<sup>35</sup>

The presumptions should be revised. We are hard-pressed to imagine any prudent transmission investment that would not make *some* contribution to ensuring reliability or reducing congestion, which means that, absent another eligibility criterion, virtually every project could be said to satisfy the statutory objectives. The additional criterion—that the transmission investment must be a *cost-effective* means of achieving those ends—is explicit in Congress’s focus not just on “reducing congestion” but on “*reducing the cost of delivered power by reducing transmission congestion.*”<sup>36</sup> If a transmission facility will cost consumers more than they save through reduced congestion, the cost of delivered power is not reduced.

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<sup>35</sup> See NOI P 17, questions 10-12.

<sup>36</sup> 16 U.S.C. § 824s(a) (emphasis added).

And while Section 219(a)'s reference to ensuring reliability is not linked expressly to cost-effectiveness considerations, the need to consider the relative costs and benefits of different means of securing reliability must be inferred. Virtually every networked transmission addition would contribute to reliability to some degree, but, in some cases, comparable reliability benefits can be achieved at lower cost by other means. It is not just and reasonable to charge customers for expensive transmission solutions (let alone to incentivize those solutions and charge customers even more) when less expensive means are available to satisfy a reliability need.<sup>37</sup> That is why Congress directed the Commission to “promote reliable *and economically efficient* transmission and generation of electricity.”<sup>38</sup>

In this light, the wisdom of establishing rebuttable presumptions based on inclusion in regional system plans or approval by state commissions or siting authorities depends on how those planning processes or proceedings are structured. Where they are shown to involve an assessment of the projected costs and benefits associated with both potential transmission and non-transmission alternatives, it may be reasonable to presume that approved projects will ensure reliability or reduce congestion in a cost-effective manner. Where regional planning or state approval processes are not shown to involve that assessment, or

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<sup>37</sup> The need for an independent limiting principle is inherent in the nature of a networked transmission system. Virtually every upgrade to the system will improve reliability. Yet transmission constraints and system weaknesses cannot be eliminated fully. The resolution of one constraint reveals another elsewhere on the system. Attempting to eliminate every bottleneck (and paying incentives for efforts to do so) would be tantamount to undertaking an impossibly expensive game of “Whac-A-Mole.” Similarly, transmission systems built to withstand N-3 contingencies would be more reliable than those built to withstand N-1 or N-2 contingencies, but achieving such levels of reliability is generally not cost-effective and has not been attempted. Unfortunately, nothing within the four corners of FERC’s incentive-rate policy currently precludes granting incentive ROEs for such efforts.

where a project has not obtained such approval, no presumption is warranted.<sup>39</sup> In that case, the incentive applicant should be required to support its request with testimony and analysis demonstrating that the proposed project would ensure reliability or reduce congestion in a cost-effective manner.

***C. Comments on the “[a]dditional [g]oals in [s]ection 219”:  
The Commission has created perverse incentives to short-  
change incremental investment and upgrades of existing  
facilities in favor of massive projects.***

The NOI states (P 19) that “[t]o date, the vast majority of applications for transmission incentives . . . have focused on the enlargement of facilities, including construction of new transmission facilities[, while f]ew applications have focused on the improvement, maintenance, and operations of transmission facilities or on increasing their capacity or efficiency.” The NOI asks what steps the Commission can take to promote capital investment focused on improving the capacity or efficiency of existing transmission facilities.<sup>40</sup>

There are at least two reasons why transmission-incentive applications have favored large-scale investment in new facilities over smaller-scale capital investment in existing facilities. First, for cost-of-service regulated transmission companies (particularly those with formula rates), the primary route to increased

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<sup>38</sup> 16 U.S.C. § 824s(b)(1) (emphasis added).

<sup>39</sup> For multi-state projects or projects in RTO regions, the presumption should arise only upon favorable completion of all relevant processes and proceedings. Thus, if a project is approved by a state commission in an RTO region but is not planned regionally through the RTO, no presumption should attach.

<sup>40</sup> *Id.* P 20 (questions 15-17).

profits is expanding rate base. The larger the expansion, the better.<sup>41</sup> And new transmission lines afford greater rate-base expansion opportunities than capital additions to existing facilities.<sup>42</sup>

Second, the Commission's existing transmission-incentive policy creates perverse incentives to avoid incremental system updates in favor of less frequent but more massive expansions. On one hand, the Commission has held (correctly) that investors should not receive incentives for engaging in routine activities,<sup>43</sup> and transmission owners may fear that incremental additions to existing facilities could be considered to be routine investments that would not be granted incentives. On the other hand, the Commission has looked favorably upon incentive applications for larger projects. The Commission has stated that project scope, including "factors such as size, dollar investment, increase in transfer capability, involvement of multiple entities or jurisdictions, and effect on the region," will be a significant factor in determining whether to award an incentive.<sup>44</sup> The Commission thus requires incentive applicants to present "data distinguishing the project from other transmission projects or upgrades that are

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<sup>41</sup> This is an example of the Averch-Johnson effect, "the tendency of companies to engage in excessive amounts of capital accumulation in order to expand the volume of their profits." See [http://en.wikipedia.org/wiki/Averch%E2%80%93Johnson\\_effect](http://en.wikipedia.org/wiki/Averch%E2%80%93Johnson_effect).

<sup>42</sup> Transmission companies that charge stated rates also profit when network load grows more quickly than projected or when their facilities are used to transmit more power on a point-to-point basis. They are also at risk to make less profit if network load grows less quickly than projected or their facilities are used to transmit less power. Formula rates allow transmission companies to recover their costs (plus a return) regardless of such dynamics. As we explain below, that is why the use of formula rates significantly reduces a transmission company's regulatory risk and why it reduces the need and justification for ROE incentives.

<sup>43</sup> *E.g.*, *Balt. Gas & Electric Co.*, 120 FERC ¶ 61,084, P 65 (2007), *reh'g denied*, 122 FERC ¶ 61,034 (2008).

<sup>44</sup> *Balt. Gas & Electric Co.*, 121 FERC ¶ 61,167, P 28 (2007), *reh'g denied*, 123 FERC ¶ 61,262 (2008).

constructed in the ordinary course of maintaining a utility's transmission system,"<sup>45</sup> and it has encouraged submission of data comparing "total investment in a range of projects to some other aggregate measure of investment, such as total rate base or recent annual investment levels."<sup>46</sup>

However well-intentioned, a policy of rewarding only out-of-the-ordinary investment creates an unfortunate incentive to forgo routine measures in order to manufacture large-scale reliability needs requiring big solutions. This has several adverse consequences for consumers. Larger investments result in larger depreciation expenses and produce non-linear increases in the ROE component of transmission rates, as additional investment increases both rate base and the rate of return applied to rate base. Linking higher ROEs to the magnitude of project costs may not spur any additional investment, but it will result in lumpier, higher-cost investments yielding the largest possible transmission-rate increases for consumers.<sup>47</sup> The Commission has exacerbated this problem by refusing to consider claims that past under-investment created the need for a large project and that the "risks" used to justify the requested incentives were thus self-inflicted.<sup>48</sup>

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<sup>45</sup> *Balt. Gas & Electric Co.*, 120 FERC ¶ 61,084, P 53.

<sup>46</sup> *Id.*

<sup>47</sup> There is also a concern that widespread reliance on incentive ROEs for large transmission projects creates a feedback loop that threatens to increase base ROEs. The Commission rejected that contention in Order No. 679-A (P 62), finding that "any incentive ROEs granted under 219 should have a minimal effect," because "the 'cash flows' being measured in the DCF method are the cash flows of entire companies," which "should not be significantly affected by an incentive return for any particular transmission project." But projects like the Maine Power Reliability Project, discussed in the text below, which will increase the utility's plant in service six-fold, contradict that assumption. The Commission should revisit the determination it reached on this issue in Order No. 679-A, taking into account the magnitude of the projects for which it has received incentive applications under that program.

<sup>48</sup> *Cent. Me. Power Co.*, 135 FERC ¶ 61,136, PP 40-41 (2011).

We request that the Commission adopt a requirement that incentive applicants show that they have taken reasonable steps to avoid or mitigate the risks on which they rely to justify incentives. Just as the Commission refrains from rewarding routine investments, it should resist approving incentives for extraordinary projects that could have been obviated by more routine investment. (That is particularly true, as discussed below, where mandatory reliability requirements now drive the need for the extraordinary investment; as the Commission itself has observed,<sup>49</sup> there is no need to incentivize that which a utility already is required to do.)

The best way to induce capital additions to existing facilities is to remove the current incentive-eligibility preference for projects of unusual scale or scope, at least where that scale or scope could have been reduced with steadier investment over time. Where large investments are needed, the Commission may facilitate them by granting appropriately justified risk-reducing incentives, such as CWIP and abandoned-plant incentives, but it should deny ROE adders for projects that merely make up for past under-investment leading to imminent reliability violations. To ensure that internal capital goes where it is needed, the Commission should deny ROE adders for other projects by the same applicant until its transmission system is brought up to a reasonable baseline reliability level.

Instead of favoring non-routine projects of massive scope, the Commission should focus its incentive-eligibility inquiry on: whether the

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<sup>49</sup> *NEPOOL, supra* n.12.

transmission project will be a cost-effective method of meeting a reliability or market need; whether the applicant is required to build the project regardless of incentives; whether the incentive-applicant has taken reasonable measures to mitigate the project risks within its control; how the remaining risks compare to the baseline transmission-investment risks that are already compensated by the base ROE; and whether the project involves innovative or advanced technologies or practices that will yield consumer benefits outweighing their incremental cost (including that of the ROE incentive). We discuss these issues below.

***D. The Commission should recalibrate the “nexus test” to focus on what investors actually have at risk and how those risks can be mitigated.***

Order No. 679 required incentive-applicants to demonstrate a nexus between the incentive(s) sought and the investment being made—i.e., that the package of incentives being requested is “rationally tailored to the risks and challenges faced” by a project.<sup>50</sup> The Commission has found the question of whether an investment is “routine” to be “particularly probative” in assessing an alleged nexus. *Id.* P 23. The NOI asks whether the nexus test’s focus on project risks and challenges remains appropriate; whether it is more appropriate for some incentives than others; and whether it would be better to focus on a project’s characteristics or effects.<sup>51</sup> It also asks: whether the distinction between routine and non-routine projects remains appropriate; what criteria should be employed in assessing a project’s scope or effects; how the Commission should account for the

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<sup>50</sup> See NOI P 21 (citing Order No. 679 P 26).

<sup>51</sup> *Id.* P 25 (questions 19 and 20).

use of formula rates or for pre-existing obligations to build the project; and whether the Commission's policy regarding the relationship between incentives and joint ownership should be changed.

1. "Risks and challenges": Incentives should address investor risk, not increase investor returns simply because a project is challenging.

A project's risks and challenges are relevant to whether an incentive is warranted. But the terms are not synonymous, and focusing on their differences helps to chart the proper course. In assessing incentive applications, the Commission should distinguish between: (1) challenges that must be overcome in order for a project to be completed; (2) the probabilities of events that might prevent project completion or that carry other negative consequences; and (3) what investors have at risk if such challenges are not overcome or such events occur. Siting a transmission line can be a difficult challenge. But from an investor's perspective, the only thing at risk if the line cannot be sited is the loss of any sunk investment. All transmission owners face risk in siting new transmission facilities, and so average probabilities of unrecoverable sunk costs should already be compensated by the base ROE. Putting that to the side, where a transmission owner enjoys abandoned-plant recovery protection either by contract or as an incentive granted under Order No. 679, that protection substantially abates any risk to potential investors associated with siting challenges.

Conversely, ROE incentives do little to help transmission investors overcome siting challenges. At most, they may encourage investors to "try harder" to overcome those challenges. But investors already have substantial

financial incentives to try hard to get transmission lines sited, so that they become used and useful and start producing a return. We are aware of no evidence identifying anything that a transmission owner would do to expedite siting and construction when offered an additional 1 or 2 percent adder that it would not do to begin recovering a base ROE approaching or exceeding 10 percent.

Rather than considering “risks and challenges” generically, the Commission’s transmission-incentive policy should focus on what potential investors have at risk and how their probabilities of loss compare to those of investors in comparable companies (because comparable probabilities of loss are compensated through the base ROE). This means that, in awarding incentives, when they are necessary at all, the Commission should start by granting those incentives that most directly affect the probability of loss and are most directly related to investor risk. This means considering CWIP and abandoned-plant incentives first and determining the extent to which they mitigate investors’ risk before considering ROE incentives.

2. Routine versus non-routine investments and  
“project scope.”

As explained above, the Commission properly rejects requests for incentives for routine projects. The Commission establishes base ROEs at levels that already balance consumer and investor interests and are designed to provide investors in public utilities with returns on equity that are equal to what a competitive market would afford. It does so by inferring the return on equity that investors in publicly-traded utilities of comparable risk demand for their

investments. A base ROE computed in that fashion should be sufficient compensation to induce investments in routine or average-risk projects.

The difficulty with granting incentives for non-routine projects, as discussed above, is that it creates incentives to short-change routine investment in favor of non-routine projects. Thus, the fact that a proposed project is “non-routine” should not be a sufficient basis for awarding an incentive. As explained above, the Commission should determine whether or not the investment is optional<sup>52</sup> and whether the applicant has taken reasonable steps to mitigate its risks before seeking incentives. This inquiry should include (but not necessarily be limited to) considering claims that steadier, incremental investment would have avoided the risks relied on to justify an incentive. If the project is cost-effective and if the remaining risks exceed that which is compensated by the base ROE—in other words, if the project is (through no fault of the applicant) abnormally risky for a company like those in the proxy group used to establish the base ROE—the Commission should consider awarding incentives, starting with potential risk-reducing incentives.<sup>53</sup>

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<sup>52</sup> If it is mandatory, it does not need an incentive—particularly not an ROE adder—to induce the investment. Stated differently, we propose that the Commission treat as “routine” any investment that is made to achieve or maintain compliance with a mandatory reliability requirement or to fulfill another legal obligation, including a contractual commitment to build.

<sup>53</sup> As noted, the Commission should consider the risk-reducing effects of granted CWIP and abandoned-plant incentives when evaluating potential ROE adders. In most cases, we submit, granting CWIP and abandoned-plant incentives will render investment in a given project *less* risky than investment in an average transmission project by a comparable company. Therefore, in most cases, we believe that granting CWIP and abandoned-plant incentives should obviate the need for (and eliminate any justification for) granting an ROE adder.

In announcing this policy shift, the Commission also should consider describing in more detail the kinds of baseline activities that it considers routine and that it expects all transmission owners to conduct. At a minimum, investments made to achieve or to maintain compliance with mandatory reliability standards or to fulfill existing contractual or regulatory requirements should be considered routine, baseline activities that typically will not merit an ROE adder. If necessary, the Commission should consider opening a separate phase of this NOI proceeding to take comments on, and compile a list of, “baseline” transmission investment activities.

3. The relationship between incentives and formula rates or other accounting and ratemaking policies

In Order No. 679, the Commission acknowledged correctly that a public utility’s use of formula rates can “enhance cost recovery certainty,” *id.* P 389,<sup>54</sup> and reduce risk. The Commission explained that “public utilities with formula rates will generally be able to flow through increased transmission investment without concern as to the Commission’s five-month suspension policy with the exception of the suspension period for approval of initial rates.” *Id.* P 386. Indeed, formula rates go a long way toward ensuring that a utility will recover all of its prudently-incurred costs regardless of factors like slowing load growth or reduced usage of the utility’s facilities.<sup>55</sup> This effect is particularly strong when formula

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<sup>54</sup> See also *id.* P 386 (noting that “formula rates can provide the certainty of recovery that is conducive to large transmission expansion programs”).

<sup>55</sup> See, e.g., *Balt. Gas & Electric Co.*, 120 FERC ¶ 61,084, P 4 (“BG&E explained that the conversion to a formula rate within its rate zone would better reflect changes in its transmission revenue requirements, track increases and decreases in expenses to prevent under or over-recovery of costs, avoid the need for frequent rate adjustment filings, and

rates are used in concert with risk-reducing incentives, such as those allowing recovery of pre-commercial costs, CWIP in rate base, or abandoned-plant costs.

Notwithstanding Order No. 679's acknowledgment of formula rates' risk-reducing effects, we are aware of no instance in which the Commission denied or even reduced an incentive because the utility recovered costs through a formula rate. To the contrary, the Commission has rejected requests to do so. In awarding ROE incentives to PSE&G for its MAPP Project, the Commission held that:

[PSE&G's] requested 150 basis-point adder will improve [its] cash flows, which are taken into account in the financial metrics used to attract external funding. We also find that the requested incentives and the cash flow implications attributable to PSE&G's authorized formula rate are not mutually exclusive but rather, together, will operate to encourage investors to invest in the MAPP Project.

*Pub. Serv. Electric & Gas Co.*, 126 FERC ¶ 61,219, P 52 (2009). But the assertion that both formula rates and ROE adders improve cash flow begs the question of how much cash flow is needed to allow the project to be built. In most cases, formula-rate recovery and *base* ROEs should provide sufficient cash flow.

The conclusory assertion that more cash is better proves nothing, and fails to balance consumer and investor interests. The Commission should revise its policy to ensure that formula rates' risk-reducing effects are accounted for in determining the need for rate incentives.

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harmonize the treatment of new facility costs with embedded transmission revenue requirements.”). There are, however, limited categories of costs that cannot be passed through formula rates. *See Balt. Gas & Electric Co.*, 122 FERC ¶ 61,034, P 11 n.14.

4. Prior contractual commitments and statutory or regulatory obligations to build.

In many cases, transmission projects are built because the relevant utility is under a legal obligation to do so or because the project will enable it to satisfy mandatory reliability requirements.<sup>56</sup> In Order No. 679-A, the Commission held that such commitments or legal obligations do not “disqualify” applicants from receiving incentives but “may have a bearing on our nexus evaluation of individual applications.”<sup>57</sup>

We are unaware of any instance in which the Commission has denied or reduced an incentive because the applicant was obligated to construct a project. Nor has the Commission identified any circumstance in which an applicant’s legal commitments or obligations would “have a bearing” on the Commission’s evaluation of an incentive request. Instead, the Commission has chastised protestors for failing to explain how a legal obligation to construct facilities bears on the reasonableness of awarding ROE adders to “incentivize” construction.<sup>58</sup>

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<sup>56</sup> Such legal obligations can arise from contractual commitments, such as those undertaken by signatories to the New England TOA. *See* TOA, *supra* n.7, Schedule 3.09(a) § 1.1(a). They also can arise from commitments undertaken as a condition of obtaining regulatory approvals (e.g., for proposed mergers) from the Commission, state commissions, or other governmental authorities.

<sup>57</sup> Order No. 679-A P 122.

<sup>58</sup> *See, e.g., Ne. Utils. Serv. Co.*, 135 FERC ¶ 61,270, P 19 (2011) (footnote omitted) (“The Commission’s statement that a prior contractual commitment or statute may have a bearing on the nexus evaluation of individual incentive applications immediately followed its rejection of the unqualified claim that such an obligation is an absolute bar to incentives; as such the Commission’s statement merely recognized that, while contractual or statutory obligations will not generally bar incentives, there may be some cases where protestors can show that such obligations are relevant to whether applicants can establish a nexus between the incentives sought and the investment being made. And here, in their protests, neither Municipals nor the Joint Protesters provided the Commission with any reason why Applicants’ obligation to build should factor into the nexus test in this particular case.”).

We submit that such holdings fail to balance investor and consumer interests. Complying with legal obligations and taking steps to satisfy mandatory reliability requirements ought to be the epitome of “routine” public utility investment. If that is not routine for a public utility, what is? It also should be obvious that up-side incentives are not *needed* to induce fulfillment of a public utility’s basic obligations, because the failure to fulfill them subjects the utility to breach-of-contract remedies and potential penalties, among other things. Granting “incentives” in such cases only increases consumer costs and diverts ratepayer capital away from other important potential investments.

Some may argue that, practically speaking, the legal obligations may not be sufficient in themselves to lead to the construction of necessary facilities—or that granting up-side incentives will prompt public utilities to construct them in a more timely fashion. There are at least two responses to such claims. First, as noted above, awarding rate incentives for mandatory projects as a matter of course prevents those propositions from being tested.<sup>59</sup> Second, to our knowledge, no one has offered any empirical evidence (or even persuasive testimony) that rate incentives actually accelerate development of projects that public utilities already are obligated to construct.

To the contrary, the available evidence shows that incentives are *not* needed to induce timely construction of facilities that public utilities are obligated

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<sup>59</sup> There are two main sources of obligations to construct transmission facilities: contractual obligations undertaken in connection with RTO arrangements and mandatory reliability requirements. The Commission has awarded rate incentives, even for mandatory projects, from the inception of both sets of obligations.

to build. To our knowledge, the only evidentiary hearing that the Commission has held to consider the need for or effects of transmission incentives was the one that preceded Opinion Nos. 489 and 489-A, approving and then sun-setting an automatic ROE adder for construction of projects in the ISO New England regional system plan.<sup>60</sup> On cross examination during the hearing before Administrative Law Judge Johnson, the New England transmission owners' witnesses "admitted that projects would be built regardless of whether the adder was granted."<sup>61</sup> To grant ROE incentives in such cases is to require customers to pay more without getting any incremental benefit in return for the additional cost.

National Grid's then Chief Operating Officer for U.S. Transmission, Jeffrey Scott, testified that his company had made "a commitment to undertake the investments that are identified within the RTO, as part of the establishment of the regional transmission organization that we've committed to."<sup>62</sup> He added that National Grid "absolutely" would continue to build new transmission consistent with those obligations, regardless of whether an incentive adder was granted.<sup>63</sup> And even before the advent of mandatory reliability standards, he was similarly emphatic about his company's commitment to investing as necessary to maintain service reliability: "[W]e would never—and I can't stress that enough—never fail

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<sup>60</sup> *Bangor Hydro-Electric Co.*, *supra* n.24.

<sup>61</sup> *Bangor Hydro-Electric Co.*, 111 FERC ¶ 63,048, P 158.

<sup>62</sup> Hearing Tr. 718:15-19, *Bangor Hydro-Electric Co.*, Docket No. ER04-157-001 (Jan. 28, 2005), eLibrary No. 20050128-4012.

<sup>63</sup> *Id.* 775:22-25.

to invest in facilities to deliver our obligations to maintain transmission service or distribution service . . . to the customers we provide it to.”<sup>64</sup>

At trial, the New England transmission owners’ witnesses were unable to identify a single way in which their companies’ behavior would change once they became eligible for an ROE adder. Mr. Scott testified that he had “never been in a position where I’ve not been able to fund what I believe is necessary expenditure on the system.”<sup>65</sup> When asked to specify how the ROE adder would affect his company’s performance, Mr. Scott replied that “I can’t sit here and give you a shopping list now, looking forward, to exactly what we are going to do, specifically in response to this incentive.”<sup>66</sup> Instead, he suggested only that “we would have to sit down here at some point in the future and view the extent to which the application of an incentive has been beneficial.”<sup>67</sup>

Such vague assertions of potential performance enhancements fail to justify charging ratepayers hundreds of millions of dollars for “incentives” encouraging public utilities to do that which they are already obligated to do. Transmission owners already have strong incentives to begin projects so that, if a

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<sup>64</sup> Hearing Tr. 591:24-592:3, *Bangor Hydro-Electric Co.*, Docket No. ER04-157-001 (Jan. 27, 2005), eLibrary No. 20050127-4007.

<sup>65</sup> *Id.* 600:6-8.

<sup>66</sup> *Id.* 727:5-7.

<sup>67</sup> Deposition of Jeff Scott 50:17-20, Exh. NECOE-47, Docket No. ER04-157-000 (filed Jan. 28, 2005), eLibrary No. 20050608-0246. Similarly, while National Grid’s expert witness, Michael Schnitzer, claimed that an ROE adder would incentivize better performance, he had not evaluated his client’s current performance or determined whether there was any room for improvement. Hearing Tr. 944:1-945:20, *Bangor Hydro-Electric Co.*, Docket No. ER04-157-001 (Jan. 31, 2005), eLibrary No. 20050131-4020. Mr. Schnitzer also acknowledged that, in practice, the Commission would not be able to determine whether the incentive had affected the transmission owner’s performance. *Id.* 986:6-987:3.

CWIP incentive is granted, cash begins flowing or, if not, the project will be placed in service quickly to trigger cost recovery as early as possible. An ROE adder is therefore unnecessary to induce timely performance.

If the Commission nonetheless continues to consider granting ROE incentives in such cases, then, at a minimum, it must find ways to make such incentives “performance-based” (as required by FPA section 219), so that consumers can be assured of receiving fair value in return for their incentive payments. As explained in Section IV.F below, when incentives are granted, the Commission should tailor them to encourage the construction of new transmission facilities on schedule and within budget. It should do so by applying any ROE adders only to budgeted costs, not to budget overruns, and it should phase out such incentives if the transmission construction falls behind schedule.

#### 5. Joint Ownership

The NOI states that “[t]he Commission has encouraged the joint ownership of transmission facilities but declined in Order No. 679 to make it a requirement for receiving incentives.”<sup>68</sup> It asks whether that approach adequately accounts for the benefits of joint ownership and whether there are other approaches to providing incentives that encourage joint ownership of transmission. *Id.* In addition to the comments below, the public power signatories to this pleading have submitted separate, supplemental comments specifically addressing the relationship between transmission incentives and joint ownership.

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<sup>68</sup> NOI P 25, question 26.

The remaining undersigned entities note simply that the analytical framework suggested in these comments is one that should promote joint-ownership opportunities. For example, where an applicant seeks rate incentives based on cash-flow needs or financing risks associated with an unusually large or complicated project, we have suggested that the applicant be required to show (among other things)<sup>69</sup> that it has taken reasonable steps to mitigate those risks before seeking incentives. An applicant might satisfy that requirement by demonstrating that it took reasonable steps to seek out potential investment partners on a non-discriminatory basis—including other public utilities, merchant transmission developers, or public power utilities. If applicants showed that they engaged in reasonable efforts to seek out partners but found no takers or were unable to reach agreement on reasonable terms, the risk-mitigation prong would be satisfied and the applicant could be eligible to receive an incentive if otherwise qualified.

***E. Interrelationship of incentives: The Commission should grant risk-reducing incentives first, and award other incentives rarely.***

The Commission has stated that receiving risk-reducing incentives, such as CWIP in rate base or abandoned-plant recovery, does not preclude receipt of ROE adders but may be a factor in assessing the propriety of such incentives.<sup>70</sup>

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<sup>69</sup> For example, where protesting parties make a *prima facie* case that steadier, incremental investment could have avoided the need for such a large or complicated project, the applicant should be required to carry the burden of persuasion to rebut such claims.

<sup>70</sup> See Order No. 679-A P 6.

The Commission frames the issue as inquiring whether the package of incentives, considered as a whole, is rationally tailored to the project's risks and challenges.<sup>71</sup>

As Chairman Wellinghoff explained, risk-reducing incentives such as "100 percent recovery of abandoned plant costs . . . substantially reduce[] (and may well eliminate) the regulatory risk faced by [a] Project."<sup>72</sup> Yet we are unaware of cases in which the Commission has denied an ROE incentive because other granted incentives, such as CWIP or abandoned-plant recovery, were deemed adequate to address a project's risks and challenges. Instead, on occasion, the Commission has reduced the amount of an awarded ROE incentive by what seems to be an arbitrary amount.<sup>73</sup>

We agree with Commissioner Norris's observation that "[t]he Commission has not articulated a sufficiently clear framework to balance requests for packages of incentives that individually seek to both limit downside risk and provide greater potential upside rewards."<sup>74</sup> We also agree that the Commission "need[s] to be able to offer consumers a clear story as to why the level and package of incentives we grant is necessary and then how it reasonably compares to other incentive award projects."<sup>75</sup>

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<sup>71</sup> *Id.*

<sup>72</sup> *PPL Electric Utils. Corp.*, 123 FERC ¶ 61,068, at 61,573 (2008) (Comm'r Wellinghoff dissenting in part).

<sup>73</sup> *See, e.g., Ne. Utils. Serv. Co.* 125 FERC ¶ 61,183, P 81 (2008) (reducing ROE incentive from 150 basis points to 125 basis points), *reh'g denied*, 135 FERC ¶ 61,270, P 29 (2011).

<sup>74</sup> *Potomac-Appalachian Transmission Highline, L.L.C.*, 133 FERC ¶ 61,152, at 61,737 (2010) (Comm'r Norris concurring).

<sup>75</sup> *Id.*

As we explained above, the ROE incentive inquiry should focus on investor risk, rather than project challenges, and should compare the investor risk associated with a project with the average project investment risk compensated by the base ROE. Where unusual risks are present, the Commission should respond by considering first the kinds of incentives that directly address and reduce such risks—e.g., recovery of pre-commercial costs, CWIP, and abandoned-plant incentives. Most often, if risk-reducing incentives are granted, they will obviate the need for an incentive ROE. (In many cases, granting CWIP and abandoned-plant incentives may render an investment *less* risky than un-incentivized investment in routine transmission projects.) In such cases, to justify an enhanced ROE while continuing to balance consumer and investor interests, an applicant should be required to demonstrate that the project involves the use of innovative or advanced technologies that are expected to produce tangible consumer benefits outweighing the incremental cost (including that of any ROE adder) of using those technologies or practices.

***F. The role of cost-estimates: The Commission should make ROE incentives performance-based to ensure that consumers receive value for the additional cost.***

FPA section 219 required the Commission to adopt, by rule, “incentive-based (*including performance-based*) rate treatments” for new transmission investment.<sup>76</sup> To date, the Commission’s incentive-rate policy has included no performance-based element. The Commission should establish a performance

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<sup>76</sup> 16 U.S.C. § 824s(a) (emphasis added).

component, in order to ensure that consumers receive enhanced value in exchange for their payment of incentives.

In Docket No. EL08-69, the New England Conference of Public Utility Commissioners (NECPUC) filed a complaint seeking to prohibit New England transmission owners from applying the Opinion No. 489-authorized ROE incentive to project costs exceeding those that were estimated at the time of Opinion No. 489. The Commission denied the complaint.<sup>77</sup> It did so because it viewed the request to apply ROE incentives only to budgeted costs as incompatible with Opinion No. 489's basis for granting the incentives. The Commission rejected assertions that it had granted incentives because of the projects' cost-benefit ratio and that the level of costs estimated at the time of Opinion No. 489 was a "core circumstance" underlying the grant of incentives.<sup>78</sup> Instead, the Commission explained that Opinion No. 489 had focused on "general factors, *e.g.*, the positive attributes of inclusion in the RTEP and the benefits expected from the incentive, rather than on the specific details of each project."<sup>79</sup>

In a concurring opinion, Commissioner LaFleur supported the denial of rehearing, because she agreed that the Commission's initial order "correctly interprets Opinion No. 489 and the basis for granting incentives in that proceeding."<sup>80</sup> Commissioner LaFleur noted, however, that "the general issues

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<sup>77</sup> *New England Conference of Pub. Utils. Comm'rs v. Bangor Hydro-Electric Co.*, 124 FERC ¶ 61,291 (2008), *reh'g denied*, 135 FERC ¶ 61,140 (2011).

<sup>78</sup> *See* 135 FERC ¶ 61,140, P 31.

<sup>79</sup> *Id.*

<sup>80</sup> *Id.* at 61,790 (Comm'r LaFleur concurring).

NECPUC raises regarding the relationship between transmission incentives and project cost estimates are worthy of further consideration,” and she encouraged parties to address such issues in response to the NOI.<sup>81</sup>

The Commission should adopt under its Order No. 679 policy a performance-based element similar to that which it rejected in connection with Opinion No. 489. It should do so both to comply with section 219’s requirement to adopt performance-based rate treatments and to ensure that consumers receive something of value in exchange for higher, incentive-laden transmission bills. That need is particularly acute if, contrary to our recommendations, the Commission continues to award ROE incentives for projects that transmission owners are obligated to build.

Consistent with NECPUC’s proposal in Docket No. EL08-69, the Commission should apply ROE adders only to budgeted project costs. Doing so would produce several salutary effects. Currently, transmission owners—particularly those with formula rates—have incentives first to lowball project estimates in order gain needed approvals and then to build the project at the highest cost that will not be deemed imprudent. Applying ROE incentives to budgeted rather than actual amounts will diminish both incentives and will better align transmission owners’ interests with those of their customers.

Doing so also will improve the quality of the cost estimates that are prepared in the course of RTO planning processes and state-commission proceedings, and will thus lead to better decision-making. That, in turn, will

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<sup>81</sup> *Id.*

enhance the Commission's ability to rely on approvals in those proceedings as the basis for concluding that a transmission project satisfies section 219's goals.<sup>82</sup> If anything, applying ROE incentives to budgeted rather than actual amounts will create incentives to over-state projected costs, but—if RTO planning processes function as they should be required to—that tendency should be counteracted by competition from non-transmission alternatives.

Applying ROE adders to budgeted rather than actual amounts also will avoid exacerbating transmission owners' incentives to build the approved facilities at the highest actual cost that will not be deemed imprudent. As the Commission knows, prudence challenges are both expensive and difficult to pursue successfully.<sup>83</sup> Accordingly, the prospect of prudence review is a very weak check on transmission-company spending. In part, that is by design because imprudence findings lead to total disallowance of the imprudent costs. But limiting the application of incentive ROE adders is much less draconian. Investors would still earn the base ROE on the portion of the rate base additions that exceed budgeted amounts but are prudently incurred. As a result, there can be no claim that such a policy would be confiscatory or otherwise unfair to investors.

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<sup>82</sup> See 16 U.S.C. § 824s(a) (stating a purpose to benefit consumers by “ensuring reliability and reducing the cost of delivered power by reducing transmission congestion”); *id.* § 824s(b)(1) (requiring the Commission to promote “economically efficient transmission”).

<sup>83</sup> See *Incentive Rate of Return for the Alaska Natural Gas Transportation System*, FERC Stats. & Regs. ¶ 31,996, at 31,861 (1978) (“The traditional tool for cost control in pipeline construction has been regulatory oversight, with the attendant threat of disallowing any investment imprudently incurred during construction. Such a regulatory approach, however, is a blunt instrument that is effective only to counteract extreme cases of management's lack of foresight or diligence. Before any costs may be disallowed from the rate base they must be shown to have been imprudently incurred, which implies that only those costs attributable to patently unreasonable management action may be disallowed.”).

To implement this policy, the Commission should require the ROE incentive applicant to set forth in its application the budgeted project cost to which the ROE incentive would be applied. In doing so, applicants should calculate the annual and cumulative ratepayer impacts of the requested incentives. Where an applicant seeks to rely on a rebuttable presumption based on project approval in an RTO planning process or state-commission or siting proceeding, the application should state the budgeted amounts that were presented in those proceedings. The applicant should be required to explain any differences between the budgeted costs included in the application and those that were presented in the RTO or state proceedings.

The Commission should not reopen ROE incentive proceedings based on later claims that actual cost overruns resulted from factors outside the applicant's control. First, there is no need to do so because the applicant still will earn the base ROE on all non-imprudent overrun amounts. Second, allowing such reopeners would diminish the applicant's incentives to forecast its costs accurately and then work to contain them.

Beyond cost containment, there is another performance element that the Commission should design ROE incentives to incorporate: the ability to complete transmission projects on the schedule adopted by the siting authority(ies) in approving the project. Especially where ROE incentives are granted despite a utility's obligation to build the project, accelerated action is one of the primary

benefits that consumers are supposed to receive in return.<sup>84</sup> To date, no mechanism has been in place to ensure that consumers actually receive benefits in exchange for the higher costs they bear. The Commission should make the receipt of ROE incentives contingent on construction of the incentivized project in accordance with the project schedule. Tying receipt of an incentive to adherence to the schedule adopted in siting the project will prevent potential siting delays from affecting a utility's ability to fulfill its performance requirements.

Where a utility is unable to complete construction in accordance with the schedule adopted by the siting authority(ies), the ROE adder should be reduced by 20 percent for each year behind schedule the project is completed. This reduction would not affect recovery of pre-commercial costs or CWIP-in-rate-base incentives. Nor would it impair recovery of the transmission owners' investment (or even the base ROE). Instead it would affect only the magnitude of the incentive ROE adder applied to the project investment. Just as applying ROE incentives only to budgeted amounts will improve cost projections, phasing out such incentives because of project delays will improve temporal planning. It also will provide powerful incentives to keep to the schedules that are established.

These improvements would yield important planning and market benefits. First, to the extent that assessments of project benefits depend on the timing of project completion, improving the accuracy of the project timeline leads to more

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<sup>84</sup> See *Conn. Dept. of Pub. Util. Control v. FERC*, Case No. 08-1199, slip op. at 4 (D.C. Cir. 2010) (“[I]n the transmission owners’ view, the incentive would provide ratepayers an unequivocal net benefit if it accelerated completion of the projects by two years. Nevertheless, another transmission owner expert witness conceded that the projects would be completed eventually whether or not they received an incentive.”).

accurate assessments of project benefits. Second, improved temporal planning of transmission projects will facilitate more accurate projections of the transmission topology used in market applications, such as determining locational capacity requirements or evaluating capacity-market delist bids. It also should improve the efficiency of generator-interconnection studies and offer more predictability to market participants who are seeking to interconnect new generation.

**G. *Individual incentives.***

The foregoing discussion explains why the Commission must modify its Order No. 679 transmission-incentive policy to better align with Congress's intent in enacting FPA section 219 and to better balance consumer and investor interests. The suggested changes in the framework to be used in evaluating incentive requests have important implications for the use of specific incentives. In lieu of repeating the foregoing discussion as it applies to individual incentives, we include brief answers to certain of the Commission's questions about specific incentives in the attached Appendix.

**V. CONCLUSIONS**

The granting of incentive rates under Order No. 679 has transferred hundreds of millions of dollars from consumers to transmission investors without any clear showing of need or benefit, either *ex ante* or *ex post*. The policy is in dire need of reform. The Commission should revise it as set forth in these comments and the attached Appendix.

Respectfully submitted,

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## APPENDIX

The following comments respond to certain of the NOI's questions regarding particular incentives (questions 33-74) and indicate the portion of the foregoing Comments that are relevant to each question.

<b>Question and short response:</b>	<b>See Comments at:</b>
<p>33. 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, 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?</p> <p>A. The Commission should not grant incentives, including CWIP or abandoned-plant incentives, for projects that applicants are obligated to build. More generally, it should not grant incentives for routine projects whose risks already are compensated adequately by the base ROE, which is established in a way that is designed to balance investor and consumer interests and to provide reasonable compensation on average for a company's risk. The Commission should grant CWIP and abandoned-plant incentives only where applicants have taken reasonable steps to mitigate their risk, and the remaining risk exceeds that which is compensated by the base ROE.</p>	<p><i>See generally § I at 6-8; see also §§ IV.D.4 at 40; IV.D.2 at 36.</i></p>
<p>34. 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?</p> <p>A. Yes, establishing a more rigorous analytical framework and clearer eligibility criteria would enhance regulatory certainty and predictability. It also will help to ensure the consumer and investor interests are appropriately balanced and that incentives will be awarded only when needed and useful, rather than as a windfall.</p>	<p><i>See generally § IV.A.1.</i></p>

<p>35. 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?</p> <p>A. The use of incentive ROE adders should be limited to circumstances in which the applicant has shown the presence of risks (or, more precisely, probabilities of investment loss) that (a) the applicant has attempted but been unable to mitigate, (b) have not been eliminated by other incentives, and (c) exceed the probability of loss associated with investment in a routine transmission project by a comparable company. Even with such limitations, granting incentive ROEs on a project-by-project basis (as we recommend) is generous to transmission investors because it is asymmetrical. The Commission's discounted cash-flow (DCF) method establishes base ROEs that correspond to companies' average levels of risk for all projects. Allowing for higher incentive ROEs for risky individual projects, without a symmetrical reduction for routine projects, is inherently generous.</p>	<p><i>See generally § I at 6-8; see also § IV.A.2 at 27.</i></p>
<p>36. Are there other considerations that the Commission should focus on when awarding an incentive ROE adder?</p> <p>A. If a project is ineligible for an incentive ROE under the framework set forth above because it is not abnormally risky, the Commission might still consider granting an incentive ROE if: (a) the project is undertaken voluntarily; (b) the applicant demonstrates that the project satisfies the section 219 criteria for cost-effective promotion of reliability or reduction of congestion; and (c) the project involves advanced or innovative technologies or practices that are expected to produce consumer benefits that outweigh the incremental cost (including incentives) of using those technologies or practices.</p>	<p><i>See generally § I at 6-8; see also §§ IV.A.2 at 27, IV.C at 34, IV.E at 47.</i></p>
<p>37. 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?</p> <p>A. Presumptively yes. If any entity believes that a public utility's base ROE is too high or too low to compensate investors for the financial risk of the company, it may seek to change the base ROE under FPA section 205 or 206.</p>	<p><i>See generally § I at 6-8; see also §§ IV.A.2 at 27, IV.D.1 at 35; IV.D.2 at 36-37; IV.D.3 at 40; IV.E at 47.</i></p>
<p>38. 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 adder?</p> <p>A. The Commission need not identify all applicable risks or challenges in advance, and should leave incentive-applicants responsible for making their cases for why the applicable base ROE is inadequate. Applicants should identify and discuss with specificity (a) what investors have at risk, (b) the probabilities of events that could jeopardize their at-risk investment, (c) what they have done to mitigate those risks, (d) how the risks compare to those that are compensated by the base ROE, and (e) how an incentive ROE will address those risks. Regardless of what upfront specificity is provided, the Commission should commit to examine incentive ROE requests more rigorously and to provide detailed explanations for whatever determinations are made.</p>	<p><i>See generally § I at 6-8; see also §§ IV.D and IV.D.1 at 34-36.</i></p>

<p>39. 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?</p> <p>A. Yes. ROEs attract capital by rewarding financial risk. They do not necessarily overcome other types of barriers, such as siting or environmental challenges. In fact, as ROE adders make transmission projects more expensive, they may reinforce other barriers. Also, if regulatory barriers cannot be overcome, financial risk is limited to the investors' lost investment. Abandoned-plant incentives mitigate that risk, making incentive ROEs a windfall to the project developer rather than needed to compensate for otherwise-unacceptable risk.</p>	<p>§§ IV.D and IV.D.1 at 34-36</p>
<p>40. 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)?</p> <p>A. The Commission should first grant risk-reducing incentives such as CWIP or abandoned-plant recovery before considering any ROE adder. Applicants who request incentive ROEs in addition to risk-reducing incentives should be required to identify with specificity the risk of loss that remains despite the risk-reducing incentives and to compare that remaining risk of loss with that which is compensated by the base ROE. In most cases, any remaining risk will be more than adequately compensated by the base ROE. In exceptional cases, as noted above, the Commission may consider incentive ROEs to induce voluntary investment in projects that involve advanced or innovative technologies or practices that are shown to produce consumer benefits outweighing their cost.</p>	<p><i>See generally § I at 6-8; see also §§ IV.D and IV.D.1 at 34-36; IV.E at 46-47.</i></p>
<p>41. 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?</p> <p>A. Yes. What investors have at risk is their investment. Assurance of cost recovery eliminates the risk that they will fail to recover their investment plus a compensatory return. Once that risk is addressed, we submit that an incentive ROE adder is an unwarranted windfall to the transmission owner.</p>	<p>§§ IV.D and IV.D.1 at 34-36; IV.E at 46-47.</p>
<p>* * *</p>	
<p>45. Is it appropriate to offer a standard ROE adder for all utilities that join or remain members of an RTO/ISO?</p> <p>A. It could be, but only if the Commission affords consumers the benefit of the construction-obligation <i>quid pro quo</i> that transmission owners agree to when joining an RTO. It is not appropriate to require customers to pay 50 basis points to induce transmission owners to join or remain members of an RTO, the terms of which include assuming a commitment to construct, and then to be obligated to pay additional ROE adders for transmission that is actually constructed pursuant to that commitment. Also, it is inappropriate to require consumers to pay an RTO-participation adder where the utility is legally obligated to join or remain part of an RTO. <i>Compare Va. Electric &amp; Power Co.</i>, 123 FERC ¶ 61,098, P 54 (2008) (awarding RTO-participation ROE adder even</p>	<p>§ IV.D.4 at 40-44.</p>

<p>though participation was mandatory).</p>	
<p>46. In the alternative, are there other incentives that the Commission should consider to encourage joining or remaining in an RTO/ISO?</p> <p>A. No.</p>	<p>§§ IV.D, IV.D.1; IV.E.</p>
<p>47. Should the existing 50 basis point adder be increased to better encourage the formation and continuance of RTO/ISO arrangements?</p> <p>A. No. There is no evidence that the existing 50 basis point adder is insufficient to encourage the formation and continuation of RTO arrangements, or that offering higher ROE adders in order to promote RTO formation or continuation would be anything more than a windfall to the transmission owners.</p>	
<p>48. Is the existing 50 basis point adder appropriately scaled to encourage the formation and continuance of RTO/ISO arrangements?</p> <p>A. Yes.</p>	
<p>49. 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?</p> <p>A. Absent protection, investors face the risk that sunk investments will not be recovered in the event that a project must be abandoned due to factors outside the investor's control. Incentives allowing recovery of 100 percent of prudently incurred abandoned plant costs substantially reduce investor risk. Insofar as most investment by proxy-group companies occurs without such incentives, the applicable base ROEs compensate for average risks of loss and likely over-compensate utilities that also receive abandoned-plant protections. Thus, utilities that receive abandoned-plant incentives generally need not receive any ROE incentive. In any event, ROE adders should not be applied to abandoned-plant costs. It is one thing to induce investment by promising recovery of sunk costs in the event of plant abandonment. The Commission should not render transmission investors indifferent to project completion by paying them the same incentive ROE regardless of whether plant ever becomes used and useful.</p>	
<p>50. Should abandoned plant costs be prohibited in instances where an affiliated project eliminates the need for a transmission project?</p> <p>A. Yes. The Commission should not award incentives in such circumstances in order to guard against self-inflicted risks.</p>	
<p>51. 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?</p> <p>A. Allowing recovery <i>of</i> but not <i>on</i> investment in abandoned plant would limit the risk of abandonment, as investors would need to complete a project in order to</p>	

<p>earn a profit on their investment in it.</p>	
<p>52. 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?</p> <p>A. Incentive applicants should be required to demonstrate that they have taken reasonable steps to mitigate their risks before seeking incentives. Applicants who pursue projects that are unnecessarily risky may not be able to make that showing.</p>	<p><i>See generally § I at 6-8; see also §§ IV.A.2 at 27.</i></p>
<p>53. 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)?</p> <p>A. See response to question 54 below. In addition, and as always, recovery of abandoned-plant costs must be limited to recovery only of those costs that were prudently incurred.</p>	
<p>54. 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?</p> <p>A. However a project is defined, it should be defined consistently for purposes of assessing abandoned-plant issues and incentive ROE issues. Applicants should not be able to aggregate projects into a single, large project to justify an incentive ROE, yet treat them as disaggregated for purposes of abandoned-plant recovery in the event that one of the projects or sub-projects is abandoned.</p>	
<p>55. 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 costs through other accounting treatments in a subsequent section 205 filing? If so, what accounting treatments would be appropriate?</p> <p>A. If the Commission grants the incentive but subsequently denies a request to recover abandoned-plant costs under the incentive, then presumably the reasons justifying that denial also would counsel against allowing recovery of the costs through other accounting treatments.</p>	
<p>56. 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</p>	

<p>costs are ultimately recovered in rates?</p> <p>A. Utilities should not receive the same ROE if they choose to abandon a project as they would if they saw the project through to completion and it became used and useful in serving customers. It would reasonably balance consumer and investor interests to allow utilities to recover 100 percent of abandoned-plant costs, without any return. In no event should an incentive ROE be applied to abandoned-plant costs.</p>	
<p>* * *</p>	
<p>60. 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?</p> <p>A. Yes, the CWIP incentive should be suspended in such circumstances. Ratepayers should not be required to pay for a project in circumstances that raise doubt about its eventual completion.</p>	
<p>* * *</p>	
<p>62. 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?</p> <p>A. In most instances, where the CWIP incentive is granted, no incentive ROE will be warranted.</p>	<p>§ IV.E at 47.</p>
<p>* * *</p>	
<p>67. 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?</p> <p>A. In most instances, where risk-reducing incentives such as recovery of pre-commercial costs are granted, no incentive ROE will be warranted.</p>	<p>§ IV.E at 47.</p>
<p>* * *</p>	
<p>69. Section 1223 of EAct 2005 defines advanced transmission technology and lists technologies that fall within that definition. How should the Commission account for what Order No. 679 identified as the evolving nature of technology?</p> <p>A. ROE adders offer investors additional profit above that which is provided through the base ROE. Base ROEs are established by reference to the activities of a proxy group of comparable utilities. Where the use of an advanced transmission technology remains uncommon for the incentive-applicant and the proxy group used to establish its base ROE, an incentive may be warranted so long as the other conditions discussed in the text are met. Once a technology or practice becomes established, either with the incentive-applicant or among</p>	<p>§ IV.A.2 at 27 &amp; n.35.</p>

<p>its proxy group, use of that technology or practice no longer warrants an incentive.</p>	
<p>70. 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?</p> <p>A. See response to question 69.</p>	
<p>71. 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”?</p> <p>A. See response to question 69.</p>	
<p>72. Where the Commission grants an incentive ROE adder for the use of advanced technology, should that adder apply to the entire cost of a project, or just to the advanced technology?</p> <p>A. Where the Commission grants an incentive ROE adder for the use of an advanced technology, it should apply only to the incremental cost of the using the advanced technology.</p>	
<p>73. 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?</p> <p>A. Whether a particular technology or practice may warrant an incentive ROE should depend on case-specific facts, including the applicant’s experience with the technology or practice, the experiences of comparable utilities in the applicant’s proxy group, and a showing that use of the technology or practice will yield consumer benefits expected to outweigh the incremental cost (including that of any incentive) of using the technology or practice. Therefore, incentives for advanced technologies should continue to be assessed on a case-by-case basis.</p>	