

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

**Promoting Transmission Investment)
Through Pricing Reform)**

Docket No. RM06-4-000

**RULEMAKING COMMENTS OF
THE NEW ENGLAND CONFERENCE OF
PUBLIC UTILITIES COMMISSIONERS**

In accordance with the Notice of Proposed Rulemaking (“NOPR”) issued on November 17, 2005, 113 FERC ¶ 61,182, the New England Conference of Public Utilities Commissioners (“NECPUC”) hereby submits its comments on the Federal Energy Regulatory Commission’s (“FERC” or the “Commission”) proposed rulemaking, Promoting Transmission Investment through Pricing Reform. As discussed in detail below, NECPUC opposes those aspects of the rule that would allow a higher return on equity (“ROE”) than otherwise would be allowed for transmission investment unless, on a case-by-case basis, the utility seeking the higher ROE demonstrates that the adder is needed. Further, NECPUC opposes an ROE adder for entities that have already joined a Transmission Organization as defined in the Energy Policy Act of 2005 (“EPAAct 2005” or “the Act”). Finally NECPUC opposes an adder for transmission owners joining a Transco¹ if that transmission owner is already a member of a Transmission Organization.

I. BACKGROUND

A. Proposed Pricing Policy

On January 15, 2003, the Commission issued its Proposed Policy Statement (“Policy Statement”) in *Proposed Pricing Policy for Efficient Operation and Expansion of Transmission*

¹ The proposed rule defines a Transco as “a stand alone transmission company that has been approved by the Commission and that sells transmission services at wholesale and/or on an unbundled retail basis, regardless of whether it is affiliated with another public utility.” Proposed 18 C.F.R. § 35.35(b)(1).

Grid, 102 FERC ¶ 61,032 (2003). In the Policy Statement, the Commission proposed a new pricing policy that would provide additive rate incentives for transmission owners that: (1) transfer operational control of their transmission facilities to a Regional Transmission Organization (“RTO”); (2) form independent transmission companies (“ITCs”) within RTOs, or (3) construct facilities that would expand the transmission grid. *Id.* at 61,065-66, P.24-32.

NECPUC filed comments in which it stated that it supported the Commission’s goals of having independent transmission operators and reducing congestion but that it did not support the proposed policy because it was not properly designed to achieve its stated objectives: “[The Commission’s] proposal would provide rewards for actions already taken and grant incentives for all transmission expansions, even when such incentives may not be necessary and may unfairly elevate transmission solutions over transmission alternatives that might accomplish the same purpose.” Comments of NECPUC, Docket No. PL03-1, at 2 (March 13, 2003).

On April 22, 2005, the Commission held a technical conference in Docket Nos. PL03-1 and AD05-5. In that technical conference some speakers, including FERC staff, questioned whether ROE adders were needed as an incentive for transmission expansion:

One theme that we heard loud and clear in terms of discussions with folks in the industry as well as comments to the earlier proposed policy statement, is that there’s a need for more flexibility in terms of the types of incentives that can be made available; that simply tacking on additional basis points on equity returns may not be what is needed.

Technical Conference Transcript at 11, Introductory Comments of Shelton Cannon, Office of Markets, Tariffs and Rates. When questioned by FERC staff, several of the speakers confirmed that ROEs are already adequate to attract capital investment in transmission expansion, but that other issues such as cost allocation, transmission siting and the integrated structure of many utilities hampered transmission expansion:

MR. CANNON: A quick follow up, and then Dick. Understandably, large regional lines are harder to build, there's no question about it. Is there something that this Commission can do in terms of fashioning its rate and recovery policies, and any incentives that it put out on the table that could help and distinguish between what's necessary in order to get the longer-distance lines, which provide some very important regional reliability benefits, and again obviously facilitate longer distance trade.

MR. LARSON: The answer, I think, to that is yes, you can, but it doesn't relate to, it's not anything additive to what the Commission is already doing. I think that the returns are adequate to motivate people to invest. I think that -- and to reinvest.²

Following the technical conference, the Commission issued a proposed policy relating to the formation of ITCs. *Policy Statement Regarding Evaluation of Independent Ownership and Operation of Transmission*, 111 FERC ¶ 61,473 (2005). FERC did not issue a policy on Pricing Reform.

B. Docket No. ER04-157

On November 4, 2003, the New England Transmission Owners (NETOs³), joined by Green Mountain Power Corporation and Central Vermont Public Service Corporation (collectively, "ROE Filers"), made a Section 205 filing to change the ROE that is used to calculate the rates for regional and local transmission services under the ISO-NE Open Access Transmission Tariff ("RTO-NE OATT"), beginning on and after the initial operations date for the New England RTO. *See* Joint ROE filing of New England Transmission Owners Under the RTO New England Open Access Transmission Tariff, Docket No. ER04-157-000 (November 4, 2003). In addition to proposing a base ROE of 12.8 percent, they proposed incentive adders of

² Technical Conference Transcript at 53, *see also id.* at 203-04 (need for pricing certainty is what stimulates investment). *See, e.g.,* Testimony of Jonathan Larson, Managing Director, Trimaran Capital Partners, *id.* at 36-37 ("It's the predictability of earnings."); Testimony of Eric Lammers, Vice President, ArcLight Capital Partners, *id.* at 203-4 ("As important as the allowed rate structure was the faith and the FERC's consistency of approach on rate structures.").

³ The NETOs include: Bangor Hydro-Electric Company, Central Maine Power Company, NSTAR Electric & Gas Corporation, New England Power Company, Northeast Utilities Service Company, The United Illuminating Company, and Vermont Electric Power Company.

50 basis points to reward RTO participation and 100 basis points for future transmission expansions. *Id.* at 2. The Commission summarily approved the NETOs' proposed 50 basis point RTO participation adder but excluded from its scope facilities subject to Local Service Schedules under the proposed RTO-NE Tariff. FERC accepted the 100 basis point adder "attributable to new transmission investment," subject to suspension, hearing and "the application of our Pricing Policy Statement (when issued)," finding that the intervenors raised issues of material fact relating to the Commission's requirements that parties seeking the 100 basis point adder "demonstrate why the adder is needed to incent investment in new transmission facilities and whether the adder should apply to all types of transmission expansion or be more narrowly focused on transmissions expansions that utilize innovative, less expensive technologies. *ISO New England, Inc., et al.*, 106 FERC ¶ 61,280, 62,057 at P.249 (2004). After an extensive hearing process, the Administrative Law Judge issued a preliminary decision, in which she found that the NETOs had failed to demonstrate, as required by law, that the 100 basis point incentive was needed. Specifically she found:

Under the March 24 Order, such a showing requires more than reliance on the Proposed Pricing Policy. March 24 Order, 106 FERC ¶ 61,280 at P 249 (citing *PJM Interconnection, L.L.C.*, 104 FERC ¶ 61,124 at P 75). I read the March 24 Order to require a showing of some link between the cost of the adder and the benefits to be derived from it. *Farmers Union* dealt with the problem of linking increases in rates to the attraction of capital needed to build new capacity. *Farmers Union*, 734 F.2d at 1494-95 & 1502-03. Here, the problem is not primarily a lack of capital. The record shows that capital is available. *See* Tr. 606. On cross-examination, Mr. Scott also admitted that projects would be built regardless of whether the adder was granted. Tr. 718, 775. Rather, NETOs and Staff in particular cite a host of other difficulties that are preventing the construction of new transmission. *See* Staff I.B. at 31; Tr. 770-82.

Initial Decision, *Bangor Hydro-Electric Company, et al.*, 111 FERC ¶ 63,048 at P.158 (2005).

She further found:

Reference to the Proposed Pricing Policy alone cannot meet the NETOs' burden of proof and the NETOs' cost-benefit analysis, while showing that new transmission facilities need to be built and that they are likely to produce savings, does not explain sufficiently the *need* for a 100 basis point adder, *i.e.* how the 100 basis point adder will produce these results.

Id. at P.164 (emphasis added). Finally, she found “evidence of the need for new transmission does not satisfy the standard of the March 24 Order to show *why* the adder is necessary to provide an incentive to invest in such transmission. *Id.* at P.166 (emphasis added).

This showing first was required for PJM. There the Commission determined that simply invoking the Proposed Pricing Policy does not establish the appropriateness of a requested 100 basis point “new facilities” adder. *PJM Interconnection, L.L.C.*, 104 FERC ¶ 61,124 at P.75 (2003).⁴ In Docket No. ER04-157, the Commission set forth two specific evidentiary showings required to be made by the utility seeking the “new facilities” adder. First, applicants seeking the incentive adder would be required to demonstrate why the adder is needed to incent new investment. Second, they would be required to demonstrate whether the adder should be applied to all new transmission expansions or should apply only to transmission expansions the utilize innovative, less expensive technologies. *Bangor Hydro-Electric Co.*, 106 FERC ¶ 61,280 P.249 (2004).

C. Energy Policy Act of 2005

On August 8, 2005, the EPAct 2005 became law. Section 1241 of the Act created new Section 219 of the Federal Power Act, 16 U.S.C. § 824s. Section 219 contains the following provisions relative to the NOPR:

⁴ The Commission recently affirmed that a utility requesting an adder for new transmission investment must demonstrate that it needs the adder. *See Southern California Edison Company*, 114 FERC ¶ 61,018 at P.15 (2006).

(a) Rulemaking Requirement- Not later than 1 year after the date of enactment of this section, the Commission shall establish, by rule, incentive-based (including performance-based) rate treatments for the transmission of electric energy in interstate commerce by public utilities for the purpose of benefiting consumers by ensuring reliability and reducing the cost of delivered power by reducing transmission congestion.

(b) Contents- The rule shall—

(1) promote reliable and economically efficient transmission and generation of electricity by promoting capital investment in the enlargement, improvement, maintenance, and operation of all facilities for the transmission of electric energy in interstate commerce, regardless of the ownership of the facilities;

(2) provide a return on equity that attracts new investment in transmission facilities (including related transmission technologies);

(3) encourage deployment of transmission technologies and other measures to increase the capacity and efficiency of existing transmission facilities and improve the operation of the facilities; and

(4) allow recovery of—

(A) all prudently incurred costs necessary to comply with mandatory reliability standards issued pursuant to section 215; and

(B) all prudently incurred costs related to transmission infrastructure development pursuant to section 216.

(c) Incentives- In the rule issued under this section, the Commission shall, to the extent within its jurisdiction, provide for incentives to each transmitting utility or electric utility that joins a Transmission Organization. The Commission shall ensure that any costs recoverable pursuant to this subsection may be recovered by such utility through the transmission rates charged by such utility or through the transmission rates charged by the Transmission Organization that provides transmission service to such utility.

(d) Just and Reasonable Rates- All rates approved under the rules adopted pursuant to this section, including any revisions to the rules, are subject to the requirements of sections 205 and 206 that all rates, charges, terms, and conditions be just and reasonable and not unduly discriminatory or preferential.

II. THE PROPOSED RULE

The proposed rule authorizes the following incentive-based rate treatments for investment by public utilities, including Transcos, in new transmission capacity that reduces the cost of delivered power by reducing transmission congestion and ensuring reliability, as demonstrated in an application to the Commission:

- (i) a rate of return on equity sufficient to attract new investment in transmission facilities;
- (ii) 100 percent of prudently incurred Construction Work in Progress (CWIP) in rate base;
- (iii) recovery of prudently incurred pre-commercial operation costs;
- (iv) hypothetical capital structure;
- (v) accelerated regulatory book depreciation;
- (vi) recovery of 100 percent of prudently incurred costs of transmission facilities that are cancelled or abandoned due to factors beyond the control of the public utility;
- (vii) deferred cost recovery; and
- (viii) any other incentives approved by the Commission, pursuant to the requirements of this paragraph, that are determined to be just and reasonable and not unduly discriminatory or preferential.

Proposed 18 CFR § 35.35(d)(1); *see also* NOPR at P.10.

The proposed rule offers additional incentives to Transcos, including “(i) a higher ROE which is both sufficient to encourage Transco formation as well as to attract new investment in transmission facilities; and (ii) an adjustment to the book value of transmission assets being sold

to a Transco to remove the disincentive associated with the impact of accelerated depreciation on federal capital gains tax liabilities.” *Id.* Proposed 18 C.F.R. § 35.35(d)(2).

Finally, the proposed rule authorizes incentives for joining a Transmission Organization, which is defined, consistent with the statute as an ISO, RTO or ITC approved by the Commission. These incentives include a ROE that is higher “than the return on equity the Commission might otherwise allow if the public utility did not join a Transmission Organization.” NOPR at P.12. In addition, the rule authorizes public utilities that join a Transmission Organization to recover prudently incurred costs associated with joining the Transmission Organization. *Id.*

III. COMMENTS

A. The Purpose Established in the Proposed Rule Should be Clarified

The proposed rule states as its purpose:

This section establishes rules for incentive-based (including performance-based) rate treatments for transmission of electric energy in interstate commerce by public utilities for the purpose of benefiting consumers by ensuring reliability and reducing the cost of delivered power by reducing transmission congestion.

Proposed 18 C.F.R. § 35.35(a).

While this section is taken verbatim from the statute, it would benefit from some clarification. For example, this section does not explain clearly how the *rule* will benefit consumers. What is missing is the causal link between the incentive rate and the construction of new transmission (1) “reducing the cost of delivered power by reducing transmission congestion” and (2) “ensuring reliability.” *Id.* If, in the specific 205 rate case, it is determined that incentives are not needed to cause the new transmission to be built, then the rules will benefit consumers only if they do *not* allow an incentive because in those cases consumers are simply paying for a windfall to the transmission owners. Such a result would be in violation of

Section 219 of the Act which requires that “all rates approved under the rules adopted pursuant to this section, including any revisions to the rules, are subject to the requirements of sections 205 and 206 that all rates, charges, terms, and conditions be just and reasonable and not unduly discriminatory or preferential.” Section 219(d), 16 U.S.C. § 824s. If the rate treatment is not necessary as an incentive for the construction of new transmission that either ensures reliability or lowers delivered power costs, then granting it clearly would be inconsistent with the just and reasonable standard of section 205. *Farmers Union Central Exchange v. FERC*, 734 F.2d 1486, 1503 (D.C. Cir. 1984) (requiring that the Commission determine that the rate “increase is in fact needed, and is no more than is needed, for the purpose”).⁵

The NOPR appears to read this provision to mean that any utility that builds new transmission may get the incentive regardless of whether it has demonstrated a lack of access to capital, or that without the incentive transmission would not get constructed: “Specifically, the Commission will consider granting an incentive-based ROE to all public utilities (*i.e.* traditional

⁵ The Commission’s 1992 Policy Statement on Incentive Regulation, *Policy Statement for Incentive Regulation*, 61 FERC ¶ 61,168 (1992) (“1992 Policy Statement”), also spelled out why it was important that any benefits flowing from incentive rates be quantified by the utility:

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

Id. at 61,590.

public utilities and Transcos) that build new transmission facilities *that benefit consumers by ensuring reliability and reducing the cost of delivered power by reducing transmission congestion.*” NOPR at P.22 (emphasis added). This view does not incorporate the just and reasonable requirement because it would allow a rate increase in circumstances where the increase was not necessary to accomplish the purpose. *Farmers Union, supra*, 734 F. 2d at 1503. Thus, while under the statute, the purpose of the rule is to benefit consumers by ensuring reliability and reducing congestion by providing incentives when they are necessary to get the transmission built, the NOPR appears to indicate that as long as the new transmission facility will have benefits to consumers by ensuring reliability and reducing congestion, an incentive-based rate treatment is appropriate, regardless of whether it is needed or its costs outweigh the benefits.⁶

In order to eliminate the ambiguity in the Rule’s statement of purpose, while maintaining consistency with the statute taken as a whole, NECPUC suggests a more focused statement of purpose:

The Commission finds that new transmission facilities can help ensure reliability and reduce congestion. The purpose of this rule is to establish the circumstances under which the Commission may grant incentive-based (including performance-based) rate treatments for new transmission facilities that ensure reliability or reduce power costs (through reduced congestion). In addition, the purpose of this rule is to establish the circumstances under which the Commission may authorize an incentive-based rate treatment for public utilities that join a Transmission Organizations.

⁶ As discussed below, applicants for incentive-based rate treatment must “*explain*” how the “proposed ROE was derived and why it is appropriate to *encourage* new investment,” NOPR P.22. The NOPR does not appear to require the applicant to *demonstrate* that the incentive ROE is *needed* and that is no more than necessary to achieve the purpose of attracting new investment.

Alternatively, the Commission could simply state as it did in the NOPR, “The purpose of the proposed rulemaking is to promote greater capital investment in new transmission capacity.” NOPR P.2.

B The Commission Should Modify its Proposed Rule to Require the Utility Seeking an Incentive Based ROE to Establish that the Increased ROE is Needed.

The statute provides that “[a]ll rates approved under the rules adopted pursuant to this section, including any revisions to the rules, are subject to the requirements of sections 205 and 206 that all rates, charges, terms, and conditions be just and reasonable and not unduly discriminatory or preferential.” 16 U.S.C. § 8245. This requires that the Commission determine that the rate “increase is, in fact needed, and is no more than is needed, for the purpose.” *Farmers Union, supra*, 734 F.2d at 1503.⁷ The rule, as currently envisioned, appears to lack such a requirement and therefore could result in rate determinations that are not just and reasonable. Instead, the proposed rule requires only, that the request include “a detailed *explanation* of how the proposed rate treatment justifies incentive-based (or performance based) treatment based on the purposes and requirements of this section.” Proposed 18 C.F.R. § 35.35(d) (emphasis added). The rule does not appear to require that the utility seeking the incentive to establish that the incentive is necessary and no more than necessary to attract new investment. If the Commission approves the incentive without such a showing it does so in direct conflict with the requirements of Section 205 and Section 206 of the FPA, and thus Section 219(d) of the FPA.

(1) The Rule Should Not Grant an Incentive-Based ROE to all Public Utilities that Build New Transmission Facilities that Benefit Consumers by Ensuring Reliability and Reducing the Cost of

⁷ In this respect, the Congressional directive to adopt incentive-based rate regulations is entirely consonant with the Commission’s 1992 Policy Statement on incentive pricing. Incentive or performance-based rates under a just and reasonable standard, it stated, should not produce higher costs to consumers than they would have paid under traditional ratemaking methods. 1992 Policy Statement, 61 FERC at 61,599.

Delivered Power by Reducing Transmission Congestion Unless the Utility Establishes on a Case-By-Case Basis that the Incentive Is Needed.

The NOPR states that “the need for capital investment in energy infrastructure is a national problem that requires a national solution.” NOPR at P.2. It further states:

Inadequate transmission infrastructure results in transmission congestion that impedes competitive wholesale markets and impairs the reliability of the electric grid. To address the need for transmission capacity, the proposed rulemaking provides price reforms applicable to the entire electric grid, in both organized and in other markets and to both vertically-integrated utilities and transcos.

Id. However, the Commission’s generalized finding about the national need for transmission investment does not answer whether there is a lack of investment in the region served by the utilities seeking the incentive and if so, how the incentive would result in additional investment. *See Farmers Union*, 734 F.2d at 1503 (citing *Williams Pipe Line Co.*, *Opinion No. 154*, 21 FERC ¶ 61,260, 61,614 (Nov. 30, 1982) (“FERC here failed to make its prediction with any specificity beyond the bald statement that ‘[e]verybody agrees that the nation needs and will need more pipeline plants.’”). In New England, for example, the NETOs own witnesses have admitted that they have sufficient access to capital. In fact, these Transmission Owners have for years willingly come forward, supported and even advocated for numerous major transmission projects which are in various stages of construction. Thus, the Commission’s broad generalizations about the need for new investment in transmission does not apply equally to all areas of the country.

Similarly, the Commission finds that “the risk profile of the transmission business is changing and the historical data typically used to evaluate returns on equity may not be reliable since it reflects a different industry structure from the one that currently exists.” NOPR at P.21. Again, in New England, however, where most transmission companies have divested their

generation, there is actually a lower risk than for integrated utilities. The risk is further reduced by the formula rate structure in New England. *See, e.g.*, Docket No. AD05-5, Technical Conference Transcript at 80, Testimony of Joseph Welch of International Transmission Company (formulary rates reduce the risk of nonrecovery, thus reducing the financing and expense associated with capital projects). *See also Northeast Util. Serv. Co.*, 56 FERC ¶ 61,269, at p. 62,053 (1991) (“guaranteed cost-of-service formula rates reduce risks”). This point is particularly important. NECPUC has already demonstrated that risk reduction, not ROE adders, is the way to encourage transmission investment. So, if the Commission desires to encourage transmission investment, formula rates, *such as those already employed in New England*, are worth considering in regions where they are not now being used:

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

Northeast Util. Serv. Co., *supra* at 62,053 (quoting *Indiana & Michigan Power Company*, 4 FERC ¶ 61,316, 61,739 (1978)) (emphasis added). The NOPR’s generalized statements, when compared against the specifics of the situation in New England, simply do not support incentive rates for this region.

The NOPR states that “the Commission will consider granting an incentive-based ROE to all public utilities (*i.e.*, traditional public utilities and Transcos) that build new transmission facilities that benefit consumers.” NOPR at P.22. The NOPR does not appear to contemplate that a showing of need be made by the applicant seeking the incentive-based ROE. To receive an incentive based ROE, a public utility need only do the following:

To receive an incentive-based ROE, a public utility must submit a request in an application under section 205 of the FPA and must support the ROE request by demonstrating how the new facilities will improve regional reliability and reduce transmission congestion. In addition, the application must explain if the facilities are part of an independent regional planning process, such as that administered by an RTO or ISO or another independent regional planning process recognized by the Commission and how the proposed ROE was derived and why it is appropriate to encourage new investment.

NOPR at P.22.

In order to comply with the FPA, the Commission must require utilities seeking incentive ROEs to do more than show that the facilities have reliability or economic benefits for consumers, they must be required to establish a nexus between the incentive and the construction of the facility. In other words, the utility must show that the incentive rate treatment is needed and the increase is no more than needed to accomplish the purpose for which the incentive is needed.

In replacing existing Section 35.34 of the regulations with the proposed rule, FERC also proposes to terminate the requirement that an applicant for incentive-based rate treatment demonstrate and quantify the benefits to ratepayers. More specifically, the Commission states that, unlike its current rules, it “does not propose to require applicants for incentive ratemaking treatment under section 35.35 to support their applications with cost-benefit analyses.” NOPR at P.16. “Customers,” it states, “will be protected by the Commission’s review of applications pursuant to sections 205, 206 and 219 of the FPA, which require that all rates be just and reasonable and not unduly discriminatory or preferential.” *Id.* However, the cost benefit analysis must be part of a just and reasonable determination. Without this analysis, the Commission simply cannot determine that the incentive rate treatment is necessary and the increase is no more than necessary to accomplish the purpose of inducing investment in

transmission that would not otherwise occur. For example, even if the Commission determined in a specific case that the utility did not have adequate access to capital, it would still need to determine whether the amount of the incentive was no more than needed to accomplish the purpose.

In some regions, such as New England, these incentives are simply not needed (1) because there is sufficient access to capital, (2) delays in project construction are not due to a lack of access to capital (3) formula rates provide rate certainty and (4) the utilities have voluntarily entered into a contractual obligation to build new transmission projects that the ISO has determined are necessary. Applying such incentive-based rate treatments to new construction in New England would not benefit New England consumers because all the necessary tools (for transmission owners) are in place. In fact, the NETOs have come forward through the Regional System Plan (“RSP”) process and expressed their willingness to build projects, the total costs of which are in the \$3 billion dollar range. Further, the NETOs witnesses testified that any delays in these projects were not due to lack of access to capital, Docket No. ER04-157, Transcript at 671, but due to issues such as siting. *Id.* at 606. Finally, the NETO witnesses could not identify anything that they would do differently if they had been given the hundred basis point adder and in fact affirm that regardless of whether they received the 100 basis point adder, they would build necessary transmission projects consistent with their obligations, *id.* at 775, and that they will make every effort to drive the projects forward. *Id.* at 777; *see also id.* at 725, 727 and 733. These facts underscore the importance of requiring a showing that the incentive is needed. In the absence of such a requirement, the Commission will be unable to defend its actions as being just and reasonable because it will be unable to

determine whether it is awarding a payment for something that transmission owners would do even without the incentives.

C. An ROE Adder Is Not Needed to Incent Investment in Transmission in New England

The NOPR asks, “whether ROE adders are an appropriate mechanism for requesting and receiving approval for an acceptable ROE.” NOPR at P.21. As discussed above, an ROE adder is not needed in New England because there is no lack of access to capital or investment in transmission in New England. Delays caused by other problems such as siting approval would not be eliminated by an ROE adder.

D. Other Incentive Mechanisms

The NOPR lists a number of additional incentives, besides possible ROE adders. These include Construction Work in Progress cost recovery of prudently incurred pre-commercial operation costs; accelerated regulatory book depreciation; recovery of 100 percent of prudently incurred costs of transmission facilities that are cancelled or abandoned due to factors beyond the control of the public utility; and deferred cost recovery.

In New England, some of these mechanisms are already available. For example, if the ISO determines that a transmission upgrade listed in the RSP is no longer necessary or feasible, and removes the upgrade from the RSP, the Transmission Owner responsible for the construction of the upgrade, will be “reimbursed for any costs prudently incurred or prudently committed to be incurred (plus a reasonable return on investment at existing FERC-approved ROE levels) in connection with the planning, designing, engineering, permitting, procuring and other preparation for construction and/or construction upgrade” that is removed from the RSP. ISO-NE OATT, Section II.48.3(d).

However, for those mechanisms not already adopted as part of the RTO approval, the Commission should decide on a case-by-case basis whether the mechanism is needed and appropriate for the utility seeking the incentive rate treatment. The Commission should not adopt any mechanism that grants generic approval of the rate devices discussed in the NOPR. First, a generic rule takes no account of whether such devices are necessary in any given case. Second, even if a ratemaking device might provide a needed incentive, there is no logical basis to assume that all of the ratemaking devices outlined in the NOPR are equally and cumulatively necessary in every case. Rather, NECPUC urges the Commission to adopt a case-by-case review of filings seeking to employ the ratemaking devices FERC identifies.

E. The Rule Should Clarify that a Utility that Has Already Joined a Transmission Organization is Not Eligible for an Incentive Adder.

The proposed rule states:

The Commission will authorize an incentive-based rate treatment, as discussed in this paragraph (e), for public utilities that join a Transmission Organization, provided that the proposed incentive-based rate treatment is just and reasonable and not unduly discriminatory or preferential. Applicants for the incentive-based treatment must make a filing with the Commission under section 205 of the Federal Power Act. For purposes of this paragraph (e), an incentive-based rate treatment means a return on equity that is higher than the return on equity the Commission might otherwise allow if the public utility did not join a Transmission Organization.

Proposed 18 C.F.R. § 35.35(e). The NOPR explains that:

For certain RTOs, such as the Midwest ISO and the Pennsylvania-New Jersey-Maryland Interconnection (PJM), the commission has considered incentives for public utilities that join an RTO by allowing a public utility that joins an RTO to receive an ROE within the zone of reasonableness that is higher than it would have received had it not joined. We will continue to consider requests for ROE-based incentives for utilities that join an RTO, in recognition of the benefits such organizations bring to customers, as outlined in detail in Order 2000. In addition, we will consider similar requests by utilities that join an ISO for an incentive ROE that, while still in the zone of reasonableness is higher than the

ROE the Commission might otherwise allow if the utility did not join.

NOPR at P.45 (internal footnotes omitted).

The statute's inclusion of ISOs as a Transmission Organization clearly indicates its view that the behavior that it seeks to encourage is having an independent entity such as an ISO or RTO to operate the transmission grid. It does not give priority to one type of Transmission Organization over another. Thus, the Commission should clarify that if a utility has already joined an ISO, it is not entitled to an incentive for joining an RTO, since the desired behavior has already occurred. If the higher ROE is an incentive for behavior that has already occurred, then it is simply a reward rather than an incentive. The FPA simply does not permit the Commission to reward a utility "in recognition" of benefits that may flow from consumers for actions already taken by the utilities.⁸

The Commission's recent decision in *Southern California Edison Co.*, 114 FERC ¶ 61,018 (2006) reaffirms this principle. There, a transmission owning utility sought a 50 basis point adder as an incentive for "joining and remaining" a member of an ISO. *Id.* at P.15. In rejecting the adder, FERC made clear that the purpose of the adder was "to encourage transmission owners to turn over the operational control of their transmission facilities to a regional transmission organization" and that once the utility had turned control of its facilities over to an ISO it could no longer claim the need for the incentive:

⁸ An ROE adder, seen in this context, is plainly a reward for past performance, not an inducement for future conduct. "[R]ewards for this past performance would raise customers' cost without providing corresponding benefit." 1992 Policy Statement, 61 FERC at 61,599. Transmission owners that have turned control of their transmission entity over to an ISO, for example, no longer need an inducement to transfer their transmission assets to an RTO – *i.e.*, another independent transmission operator -- and providing them a reward after the fact cannot, by definition, provide them with an *incentive*. See, *e.g.*, *ISO New England, Inc.*, 96 FERC ¶ 61,359 at 62,355 (2001) ("Applying [deficiency charge] retroactively would not provide an incentive, since LSEs and others would have already made their decisions."), *aff'd*, *Sithe New England Holdings LLC v. FERC*, 308 F.3d 71 (1st Cir. 2002); *New England Power Pool*, 97 FERC ¶ 61,039 at 61,480 (2001), *on reh'g*, 98 FERC 61,249 (2002) (concluding that a "proposal cannot provide an incentive to encourage procedures that have already been completed.").

15. With respect to Edison’s request for the 50 basis point adder, it is true that the Commission has granted an incentive adder to transmission owners for joining a regional transmission organization. However, the Commission has stated that that “adder [is] intended as an incentive for transmission owners to turn over the operational control of their transmission facilities to an entity responsible for providing regional transmission service under the terms and conditions of a regional tariff.” The rationale for this incentive is to encourage transmission owners to turn over the operational control of their transmission facilities to a regional transmission organization; therefore, it does not apply to transmission owners who have already done so, as they need no inducement to take such an action. Since Edison turned over its transmission facilities to the ISO almost eight years ago, we deny its request for an incentive adder for joining and remaining a member of the ISO.

Id. (internal footnotes omitted).

F. The Final Rule Should Not Treat Transcos differently from other Transmission Organizations.

The statute requires the Commission to adopt rules giving utilities that have not yet joined Transmission Organizations an incentives to do so. However, if a utility leaves an ISO or RTO to join a Transco because it believes that a Transco is more advantageous from a business perspective, there is no reason to grant the utility a higher ROE.

The statute provides:

(c) Incentives- In the rule issued under this section, the Commission shall, to the extent within its jurisdiction, provide for incentives to each transmitting utility or electric utility that joins a Transmission Organization. The Commission shall ensure that any costs recoverable pursuant to this subsection may be recovered by such utility through the transmission rates charged by such utility or through the transmission rates charged by the Transmission Organization that provides transmission service to such utility.

16 U.S.C. § 824s(c). This section treats all Transmission Organizations the same. There is no priority given to one type of transmission organization over another. Thus, on a prospective basis, this subsection makes a utility that joins one of these types of Transmission

Organizations, eligible for an incentive as long as the rate treatment meets the just and reasonable requirements of the FPA. There is no evidence of Congressional intent to allow a utility that has already joined a Transmission Organization to get a higher ROE simply for choosing a *different* form of Transmission Organization, nor would it be a logical approach. First, the statute could have separated out Transcos as did FERC in its rule and made clear that any utility joining a Transco, even if it was already in an ISO or RTO, was eligible for an incentive. It did not do so. Second, Congress's interest in having the transmission facilities of individual utilities operated by an independent entity is met by the utility joining any of the types of Transmission Organizations outlined in the statute. Therefore, any change in the form of the Transmission Organization does not further Congress's intent or benefit consumers.

The discussion of Transcos in the NOPR does not succeed in justifying separate treatment in the incentives rule. The discussion focuses on why Transcos are more likely to invest in transmission than integrated utilities but does not demonstrate that Transcos are any more beneficial than other types of Transmission Organizations such as ISOs or RTOs.⁹

⁹ The Connecticut Department of Public Utility Control, a member of NECPUC, has filed separate comments on the application of incentive mechanisms to independent Transcos.

V. CONCLUSION

For the reasons discussed above, NECPUC urges the Commission to modify its proposed rule as outlined in these comments.

Respectfully submitted,

/s/ Harvey L. Reiter
Harvey L. Reiter
John E. McCaffrey
Lucy Holmes Plovnick
Stinson Morrison Hecker LLP
1150 18th Street, NW
Suite 800
Washington, D.C. 20036-3816
(202) 785-9100 (Telephone)
(202) 785-9163 (Facsimile)

*Counsel for New England Conference of Public
Utilities Commissioners*

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