

BEFORE THE
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Promoting Transmission Investment) Docket No. RM06-4-000
Through Pricing Reforms)

**COMMENTS OF THE PUBLIC POWER COUNCIL ON THE
COMMISSION’S NOTICE OF PROPOSED RULEMAKING**

On November 18, 2005, the Federal Energy Regulatory Commission (Commission) issued a Notice of Proposed Rulemaking in the above referenced docket and solicited comments on the proposals set forth in that Notice.

Promoting Transmission Investment through Pricing Reform, 70 Fed. Reg. 71,409 (Nov. 29, 2005), 113 FERC ¶ 61,182 (2005) (NOPR). Public Power Council offers the following comments in response to the Commission’s NOPR.

I. Public Power Council’s Interests

Public Power Council (PPC) is a non-profit Washington corporation that represents the common interests of more than one hundred publicly- and cooperatively-owned electric utilities throughout the Pacific Northwest. PPC represents its members’ interests in wholesale power and transmission supply, rate, and planning matters.

PPC member utilities are statutory preference customers of the Bonneville Power Administration (BPA), and meet some or all of their wholesale power requirements through purchases of BPA power. Many PPC member utilities also

purchase and sell wholesale capacity and energy within the Northwest and the Western Interconnection. All PPC members purchase transmission services from BPA, and many of these utilities also purchase transmission services from interconnected investor-owned and consumer-owned transmission providers. A few PPC member utilities provide transmission services but nearly all PPC members depend on purchased transmission services to bring power to their loads.

PPC's members are interested in ensuring that adequate transmission capacity is available in the Western Electricity Coordinating Council (WECC) region to move power from distant resources to load centers. We are also concerned that the cost of transmission should reflect the cost of providing such service, and not be inflated unreasonably.

II. Communications

PPC requests that the following persons be included on the official service list for these proceedings, and that all correspondence, communications and pleadings be served upon:

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III. Comments

A. Introduction

In passing section 1241 of the Energy Policy Act of 2005 (EPA05), Congress recognized the need for new investment in U.S. transmission systems. This expressed need, however, is not an unqualified one but rather is explicitly bounded. Section 1241, now new section 219 of the Federal Power Act, states in subsection (b) that the Commission shall by rulemaking:

- (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.

Federal Power Act § 219(b) (2005).

Congress has not evidenced a desire to build any transmission anywhere.

The first directive regarding the Commission’s rule is that it promote “reliable and economically efficient transmission” Federal Power Act § 219(b)(1). This

objective limits the balance of section (b)(1) that calls for transmission system expansion and improvement and should guide the Commission in its implementation of section (b)(2). Moreover, section 219(d) provides that all rates established under section 219 must be just and reasonable. This alone should preclude a rule that provides incentives for transmission that does not create lower delivered power prices, demonstrably improve reliability at the most reasonable cost, or provide other quantifiable benefits to consumers that offset any increased costs.

B. The Commission Should Act To Obtain Better Information Regarding The Level Of Additional New Investment That Is Needed And The Actual Difficulty In Securing Capital For Those Investments.

Difficult questions remain, such as “how much transmission investment” is needed and “which transmission investments” are needed. Both questions bear on the Commission’s proposed rule. The question of “which” investments are needed is addressed in part in section C(1) below. The question of “how much” is taken up here.

How much new transmission is needed will depend significantly on the size of the transmission capacity “deficit,” the measurement of which is partly subjective. We can say with some confidence that a significant amount of additional transmission capacity is currently planned-for by utilities, which provides a rough measure of the existing deficit. The recent study by the Edison Electric Institute (EEI study) determined that investor-owned utilities have published plans totally \$28 billion in new transmission investment for the 2004-

2008 period. Edison Electric Institute, *EEI Survey of Transmission Invest: Historical and Planned Capital Expenditures (1998-2008)*, May 2005 (EEI Investment Survey), p. 5 & p. 6, Table 1.¹ Although one needs to distinguish carefully between planned versus financed investment projects, the EEI figure is very encouraging, as the forecast represents a 60 percent increase in investment over the historical data for the preceding four-year period. *Id.* at p. 1. Based on the historical data, the EEI Investment Survey states that “[s]urvey results suggest that the industry has reversed a long-standing downward trend in transmission investment.” *Id.* at p. 3.

The investment forecasted to be made by investor-owned utilities alone may be more than the \$5 billion per year that the Commission projects the country will need. NOPR, ¶ 1. Moreover, the EEI study does not include the investments of non-jurisdictional entities, which will add to the total amount of planned investment. As noted above, however, we must take care to distinguish between merely planned facilities additions and facilities additions for which funding has been secured. For many reasons, including lack of financing, many planned facilities are never built or are significantly delayed.

Thus, we get to the nub of the issue proposed to be addressed by the Commission’s NOPR: how significant a problem will it be in the future to raise the investment dollars needed to finance planned transmission projects? The

¹ EEI’s study forecasts that the industry’s investor-owned utility segment will construct additions totaling \$4.6 billion in 2004, \$5.6 billion in 2005, \$6.0 billion in 2006, \$6.1 billion in 2007 and \$6.1 billion in 2008. EEI Investment Survey at p. 6 Table 1.

Commission's NOPR does not provide a clear picture of the difficulties or an analysis of the current investment climate. Many in the industry point to the last ten years as an indication that incentives are necessary to attract the needed capital. Certainly, during the late 1990's utilities did have difficulty competing for investment dollars with short-term, high-yield investments. With the crash of the stock markets and the dramatic constriction of the high-technology industry, however, a significant source of that competition has been removed. It is not clear that today utilities have the same difficulty getting investment dollars from capital markets that they once did. At this point, it is not clear how much incremental incentive is required, if any, for utilities to build needed transmission capacity.

Empirical evidence and analysis, rather than theories or speculation, are required to answer this question. PPC encourages the Commission to delve more deeply into this question of capital availability for utilities, whether or not it goes forward with its proposed slate of reforms. If some of the Commission's proposed incentives are to be implemented, a far greater depth of knowledge on the subject of capital availability will be required in order to determine just and reasonable returns on equity, hypothetical capital structures and the like.

C. Transmission Investment Incentives Applicable To Transmitting Utilities And Electric Utilities That Are Not Members Of Transmission Organizations Or Are Not Transcos.

It is axiomatic that new and more efficient transmission facilities are expensive to construct and take a significant amount of time to plan and complete.

If new transmission capacity is needed and transmission investment dollars are

limited, it is critical that the right transmission investments be made. Incentives should help utilities construct needed transmission investments that cannot otherwise attract sufficient capital, but these incentives are unnecessary and undesirable for all transmission investments that can be financed through conventional means.

1. Classes Of Investments That Should Be Eligible For Incentives.

The Commission should permit investment incentives only in certain circumstances. The level of the incentives should be set on a case-by-case basis under the circumstances of the particular investment and the investment climate generally (the difficulty in attracting capital at the time the investment is made).

As a general matter, incentives should be made available only for transmission investments that are demonstrated to add needed capacity to the system, that provide benefits in excess of their costs, and that involve a demonstrable risk to the recovery of the investment. If parties have to build to meet mandatory reliability requirements or if they would build the new facilities without incentives, then there is no need to provide incentives beyond what is at that time a competitive, risk-adjusted return on equity (ROE). Mandatory reliability standards must be satisfied and no incentive should be required to induce utilities to meet them. New section 219 does not provide otherwise.

Section 219(b)(4)(A) states only that the Commission shall allow the recovery of “all prudently incurred costs necessary to comply with mandatory reliability standards” Federal Power Act, § 219(b)(4)(A). It does not suggest that the

Commission should provide incentives to utilities to comply with those mandatory standards.

Moreover, the Commission should require the project's proponent to demonstrate the need and value of the proposed project in order for the project to qualify for incentives. It should not be sufficient that the proposed project adds transmission capacity to the transmission system. The addition should relieve a transmission constraint or reduce the price of delivered power or provide some other quantifiable, demonstrable benefit that would not be provided but for the incentives.

Utilities can and should be encouraged to demonstrate the need for and value of a proposed project through a regional transmission planning process or other regional peer review process. Properly designed and regionally accepted planning processes can greatly assist in identifying the best solution to a transmission problem and the best allocation of regional resources and investment dollars. Projects that emerge from such regional processes should be given higher priority access to scarce capital resources, but that does not necessarily mean that additional incentives are in all cases required in order to get the transmission built.

2. The Appropriate Types And Levels Of Incentives For Eligible Investments.

With regard to the specific proposals in the NOPR, PPC offers the following comments:

a. Returns on Equity (ROE) (NOPR ¶ 20-22).

PPC is not opposed to enhanced ROEs, if justified. Those ROEs, however, must be just and reasonable and that determination must be based on the investment climate in existence at the time the investment is made. For example, the U.S. has seen great swings in investor attitudes in the last ten to fifteen years. The pendulum has swung from a willingness to invest in conservative, long-term investments with low risk to the investment's return, to an extreme demand for short-term, high-return and high-risk investments in high tech ventures, and again towards lower risk investments with guaranteed returns.

It is impossible to determine what the capital markets will regard as a desirable investment in the future. In order to ensure just and reasonable rates, the Commission should allow no greater an ROE incentive than is absolutely necessary to attract capital when that capital is needed to fund the proposed transmission addition. Equally importantly, the Commission should require the proponent of the incentive to demonstrate convincingly, through empirical evidence and expert analysis, that a particular ROE is required in its case to attract capital.

b. Ratebasing 100 percent of Construction Work In-Progress (CWIP) (NOPR ¶ 23-28).

Permitting the ratebasing of 100 percent of the CWIP is a complicated proposition. Although improving the cash flow positions of utilities that are undertaking transmission system improvements could be desirable, it raises equity issues regarding who pays for the addition and how much is paid. Putting off the

recovery of costs until facilities are used and useful gives the sponsoring utility real incentives to ensure that (a) the facilities are completed and (b) the facilities are completed in a timely manner. Permitting a utility to recover 100 percent of the CWIP in rate base erodes these protections and incentives.

The Commission must give weight to this concern if it determines to go forward with rules that permit ratebasing these costs. The Commission must ensure that a reasonable relationship exists between the addition of CWIP to the ratebase and the timeline for energizing the new facilities. Facilities that fall behind schedule should lose their ability to ratebase CWIP or pay some penalty.

Also, the Commission must consider how it will handle the refund of monies paid through rates for CWIP if the new transmission facilities are never completed. The problem of facilities that do not become used and useful could be mitigated by the imposition of a required waiting period that postpones the date on which CWIP can be ratebased, so as to provide greater assurance that the facilities is underway and will be completed. Even this may be insufficient in some cases. When refunds are required, the Commission should order the utility that collected the money to refund it with sufficient interest to make ratepayers whole for the time value of the money that they lost.

In any event, the Commission will also need to consider the accounting requirements that it will impose on utilities that wish to ratebase the CWIP. Ratepayers must be assured that costs and monies recovered through the rates

match when the project is complete. True-ups will be required and should be undertaken from time to time as the project progresses.

Rate-basing CWIP is not the only potential source of capital for investments, in any event. If the process of approving new transmission investments were separated into “certificate of need or necessity” and “cost recovery” phases, utilities could obtain certificates of need before securing funding from lenders, with the knowledge that prudently incurred costs on such a project would be recovered from ratepayers in future.

c. Expensing Pre-Commercial Operations Costs Currently Booked To A Holding Account And Later Capitalized (NOPR ¶ 25).

Permitting utilities to expense pre-commercial operations costs raises issues that are similar to those raised by ratebasing 100 percent of the CWIP. The Commission must ensure that ratepayers do not pay more than the actual costs and that they are not required to pay costs for facilities that are never completed.

d. Use Of Hypothetical Capital Structures (NOPR ¶ 29).

If the Commission wishes to apply hypothetical capital structures to utilities to provide incentives to build needed transmission facilities, the Commission needs to establish reasonable boundaries on their use. Applying to a utility’s proposed investment a hypothetical capital structure that has more equity than the actual structure would provide an incentive (subsidy) to the utility, but the consequent rates imposed on customers run the risk of being unjust and unreasonable. PPC encourages the Commission to develop objective limitations

on the use of hypothetical capital structures and on the types of hypothetical structures and their effects on rates. Use of hypothetical capital structures would obscure the ratepayers' subsidy to the utility, which is undesirable.

If an incentive is needed, it is better policy to make that subsidy plain and have a open inquiry into the appropriate level of the incentive. Rather than apply a hypothetical capital structure to provide an incentive it would be preferable to provide an enhanced ROE, which the proponent of the incentive must objectively and empirically justify. This more transparent approach is more likely to result in demonstrably just and reasonable rates.

e. Accelerated Depreciation (NOPR ¶ 30).

Regarding accelerated depreciation, PPC believes that the depreciation periods should be reasonable and tied to some particular feature of the facility that makes accelerated depreciation appropriate.

f. Recovery Of The Costs Of Abandoned Projects (NOPR ¶ 31-34).

If the project is abandoned for reasons wholly and completely beyond the control of the utility, then it is reasonable to recover some of those costs from ratepayers. The Commission should examine the project, however, and should not permit recovery from ratepayers if the nature of the project was sufficiently speculative in nature, or if it was abandoned for reasons within the control of the utility. In such cases, shareholders should bear the sunk costs.

Other projects will present particular issues. The costs of some abandoned projects, for example those projects undertaken to interconnect or facilitate the integration of power from a merchant generator to a particular market, should be borne by parties other than ratepayers or shareholders. We encourage the Commission to ensure that the contracts between utilities and merchant generators clearly allocate to the generators the liability for the costs of abandoned facilities, the construction of which was undertaken for the benefit of the generators.

g. Deferred Cost Recovery By Utilities With Retail Rate Caps (NOPR ¶ 35).

The Commission should take great care to avoid trespassing into the jurisdiction of state utility commissions with regard to the setting of retail rates. Many state commissions have placed retail rate caps on their utilities, and it is within their authority to do so. Were the Commission to permit the deferral of costs of construction of new transmission facilities, thereby allowing them to “beat the cap,” the Commission could significantly undermine the retail scheme and protections that the state sought to provide.

3. Transco’s Should Not Receive Additional Incentives And Public Utilities That Are Members Of RTOs Should Not Receive Incentives In Excess Of Those Received By Other Public Utilities.

Utilities that form Transco’s or join Transmission Organizations should be eligible to receive the same benefits that are afforded other utilities, but they should not receive additional incentives. The Commission’s rationale for providing additional incentives for Transco’s is that Transco’s provide additional

benefits to the transmission system not provided by ordinary utilities. NOPR ¶ 39.

This rationale has not been demonstrated to be well-founded. Unless a Transco can objectively and empirically be demonstrated to provide such *additional* benefits, there is no defensible rationale for providing additional incentives to it.

Similarly, Transmission Organizations have a poor track record with construction of new transmission facilities.² There is no empirical basis for favoring these organizations over traditional utilities in the construction of new needed transmission facilities. Nor should rate incentives for new, needed transmission investment be used as a tool to lever more utilities into such organizations. It is not warranted or desirable.

Section 219 provides no independent basis for providing additional incentives. Section 219 states that the Commission shall provide incentives to such utilities but does not direct or even suggest that the Commission provide those utilities with additional incentives to join such organizations. EPA05 is conspicuously silent on the subject of whether Transmission Organizations are desirable, and section 219(c) cannot fairly be read to authorize the Commission to provide incentives to the utilities that join such organizations that are greater than those incentives that are available to other, non-member utilities.

² The Commission proposes to provide “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.” NOPR, proposed amended 18 CFR § 35.35(e); *see also* NOPR ¶ 45.

4. Utilities Selling Assets To Transcos Should Not Receive An Adjustment To The Assets Book Value And Should Not Be Able To Recover Accumulated Deferred Income Tax.

PPC opposes the NOPR's proposal to provide "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." NOPR, ¶ 11. This incentive to form Transcos is justified neither by the Federal Power Act nor the facts in evidence and is likely to have an immediate and negative impact on ratepayers. The proposed adjustment to book value will encourage existing Transmission owners to rid themselves of underperforming transmission assets in exchange for a highly profitable return unrelated to the value that a Transco might or might not produce. The outcome will be costly in the form of increased transmission rates to the Transco customers.

The Commission also proposes the incentive of allowing recovery of accumulated deferred income tax (ADIT). NOPR ¶ 43. This proposal goes beyond the stated goal of promoting investment in *new* transmission capacity. Instead, the proposed incentive would promote the sale of *existing* transmission assets, with no demonstration that the sale would result in any improvement of the assets. In a growing market, ADIT will grow within companies, and these taxes will not be owed until the associated timing differences between depreciation for allowed for tax purposes and depreciation in accordance with generally accepted accounting principles are reversed. This timing difference reversal could take several years to occur. Allowing the purchaser of the assets to amortize ADIT into

rates will serve to increase costs borne by the ratepayers, while failing to offset any actual expenditure. The effect will be to allow Transcos to benefit from the time-value of money. The value of ADIT should be passed through to customers only if the Transco is actually making tax payments, and then only in an amount equal to those payments. Further, the increase in rates should be conditioned on a demonstration of need and cost-effectiveness. That is, each Transco must demonstrate that it can actually do a better job of managing the purchased assets than the original owner.

IV. Conclusion

In promoting investment in needed transmission facilities, the Commission should employ those tools that achieve adequate and appropriate transmission investment at the lowest reasonable increase to wholesale transmission rates. PPC hopes that its comments assist the Commission in achieving this goal.

DATED this 11th day of January 2006.

/s/

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