

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

Promoting Transmission Investment)
Through Pricing Reform)

Docket No. RM06-4-000

**SUPPLEMENTAL COMMENTS OF THE
EDISON ELECTRIC INSTITUTE**

The Edison Electric Institute (“EEI”) hereby files comments to supplement its initial comments (“EEI Initial Comments”) filed on January 11, 2006 in response to the Notice of Proposed Rulemaking (“NOPR”) issued in this proceeding. These supplemental comments are being submitted in response to staff’s suggestion to many interested stakeholders that written comments addressing implementation issues would be useful. These supplemental comments address implementation issues with respect to the transmission incentives. They do not replace EEI’s original comments but are intended to complement those original comments.

In this rulemaking, the Commission has proposed attractive returns and a number of other incentives including 100 percent of construction work in progress (“CWIP”) in rate base, the expensing of pre-commercial operations costs, hypothetical capital structures, accelerated depreciation, recovery of costs of abandoned facilities, and deferred cost recovery. The Commission also has included provisions ensuring the recovery of prudently incurred costs related to transmission infrastructure that is constructed pursuant to sections 215 and 216 of the Federal Power Act. As discussed in our initial comments, EEI strongly supports these proposed incentives.

In addition, as we shall discuss in these supplemental comments, we strongly believe that it is essential for the Commission to articulate a clear and objective set of criteria that establish with certainty a utility's eligibility for such incentives. Moreover, EEI proposes an elective process whereby utilities may make section 205 filings for the recovery of costs related to new transmission projects, again in order to achieve certainty and to begin to receive appropriate incentives long before a facility is put into service. Because of the long lead time to plan, design, purchase land for, and construct transmission facilities, any process that requires utilities to wait until a new facility is placed into service or until the next rate case to learn whether they qualify for incentives creates uncertainty and greatly diminishes the effectiveness of the incentives that the Commission has proposed.

The purpose of these supplemental comments is to identify specific rules and procedures that would make clear what projects are automatically entitled to incentives and to enable a utility to obtain expedited approval of at least some of the proposed incentives, so as to support transmission construction in a timely and certain manner. These comments also identify a modification to the Commission's suspension policy that would eliminate a disincentive to incur additional transmission expense.

I. THE COMMISSION SHOULD ESTABLISH CLEAR STANDARDS AND PROCESSES FOR DETERMINING ELIGIBILITY FOR TRANSMISSION INCENTIVES AND INCORPORATING THEM INTO RATES.

The construction of new transmission infrastructure is highly capital intensive, and new projects often take several years to plan and construct. By modifying current rate regulation and accounting processes to allow 100 percent of CWIP in rate base and

the expensing of pre-commercial costs for transmission owners that request these measures, the Commission can assist in providing additional cash flow to utilities that are investing to expand the nation's electricity infrastructure and for which cash flow incentives will remove an obstacle to construction.¹ In addition, the Commission can, by rule, make all new transmission construction projects eligible for 100 percent "abandoned plant" recovery upon request, thus eliminating the risk that approved transmission investments might become unrecoverable due to future decisions outside the control of the utility. All of these regulatory reforms are consistent with and support Congress's and the Commission's goal of increasing investment in transmission infrastructure and should be made available without qualification.

Furthermore, EEI believes that all new transmission investment should qualify for a 100 basis point return on equity ("ROE") adder. *See* EEI Initial Comments at 10. At the corporate level, if it is not clear whether a transmission project qualifies for an ROE adder incentive, the project will be at a disadvantage in competing for investment capital as compared to projects that have more certainty of realizing higher returns. To provide regulatory certainty and allow for transmission projects to compete more effectively with alternative investment projects, the Commission should establish pre-approved criteria to ensure eligibility for ROE adders for new transmission construction projects, pursuant to a simple self-certification process.

¹ EEI notes that not all utilities will desire cash flow or other particular incentives, and we do not mean to suggest that any particular incentive should be applied in all situations. We note throughout these comments that incentives for investment should be available if a utility requests them.

EEI also proposes that utilities that so desire have the option of participating in a limited section 205 filing process to expedite the inclusion of these automatic incentives and pre-approved incentives for qualifying projects into utility rates and to create a favorable environment for transmission investment. Alternatively, utilities that file rate cases may propose the 100 basis point incentive in their respective rate cases. In those cases, the Commission should summarily approve the 100 basis point adder on new transmission projects that meet at least one of the objective criteria discussed below.

A. THE TRANSMISSION INCENTIVE PRICING RULE SHOULD PROVIDE THAT ALL UTILITIES QUALIFY FOR CERTAIN INCENTIVES IF REQUESTED.

EEI proposes that, in the Commission's final rule in this docket, the following four incentives should be made applicable without qualification to all utilities that request the incentives: (i) recovery of up to 100 percent of transmission-related CWIP in rate base; (ii) recovery of all prudently incurred pre-commercial costs; (iii) recovery of all prudently incurred transmission-related "abandoned plant" cost; and (iv) deferred cost recovery.

1. CWIP

One of the disincentives to transmission investment is the significant time lapse from the time a utility begins incurring costs associated with constructing transmission facilities until the commercial operation date when the utility can begin recovering its costs through the inclusion of the facility in rate base. Allowing utilities to recover up to 100 percent of CWIP in rate base, upon request, will encourage transmission construction through improved cash flow and greater rate stability and will have the benefit of lower future rates to customers.

In allowing a utility to include transmission-related CWIP in rate base upon request, the Commission should waive the requirement that a utility requesting CWIP must provide a forward-looking allocation that estimates the average use a wholesale customer will make of the utility system over the life of a project, as currently is required by 18 C.F.R. § 35.25(c)(4). The purpose of this required forward-looking allocation is to protect wholesale customers against a “double whammy,” *i.e.*, being required to pay for the construction of generation facilities and then being required to pay again for generation facilities if the customer switches its power supplier. The “double whammy” concern is not present with respect to transmission facilities because the customer will almost certainly not switch transmission suppliers.²

2. EXPENSING OF PRE-COMMERCIAL OPERATIONS COSTS

The final rule should provide utilities with the option to either expense or capitalize all prudently incurred transmission pre-commercial operations costs, including all planning and design costs. *See* EEI Initial Comments at 16. These costs are likely to be significant, especially for high voltage transmission facilities. Allowing a utility the option to recover these costs on a current basis can improve cash flow and reduce construction costs by minimizing the amount that needs to be financed by debt or equity and will further facilitate the new construction financing.

² A transmission owner’s eligibility for 100 percent of CWIP in rate base does not affect and would not be affected by how the costs of new transmission facilities are allocated. For example, in many RTO/ISO regions, cost allocation has been or will be determined through regional processes.

3. RECOVERY OF 100 PERCENT OF COSTS OF ABANDONED FACILITIES

Utilities face a risk that a transmission project for which they spend substantial dollars for planning, development, and even construction may not be able to be completed because facilities can be cancelled or abandoned due to factors outside the control of the public utilities requesting cost recovery. This is especially true of large transmission projects that can take several years to plan and build and that typically involve a number of stages: planning, seeking approvals, purchasing land, and constructing the facilities.

EEI believes that the Commission's current policy of limiting recovery to only 50 percent of a utility's prudently incurred investment in abandoned or cancelled plant presents an obstacle to investment in large-scale transmission projects. *See* EEI Initial Comments at 19. In *Southern California Edison Co.*, P 61, 014 at P58-61, *reh'g denied*, 113 FERC P 61,143 at P 9-15 (2005), the Commission granted a public utility's request to recover 100 percent of prudently-incurred costs even if the subject facilities are abandoned or cancelled. The Commission should, by rule, extend this recent precedent on abandoned cost recovery to all utilities whose projects have been abandoned or cancelled for reasons beyond their control and that request such cost recovery.

4. DEFERRED COST RECOVERY

The prospect of being required to depreciate newly constructed transmission facilities without being able to recover them in rates can be a significant disincentive to the construction of new facilities. The Commission should establish in the final rule that any utility that constructs new transmission facilities is automatically entitled to defer

recovery of the costs of those facilities in FERC-jurisdictional rates if the utility is subject to a retail rate moratorium.

B. UTILITIES SHOULD BE ENTITLED TO A TRANSMISSION CONSTRUCTION ROE ADDER INCENTIVE, PROVIDED THAT THEY MEET ESTABLISHED ELIGIBILITY CRITERIA.

The Commission should establish objective criteria, as discussed in the remainder of this section, to provide certainty for utilities seeking to qualify for a 100 basis point adder to the base return on common equity for any transmission construction project. Additionally, the Commission should establish an optional procedure whereby utilities can demonstrate in limited section 205 filings that they qualify for the 100 basis point adder for specific projects because the utilities meets any one of the eligibility criteria. As with the “automatic” transmission incentives described above, the goal here is to establish a definitive process that will allow a utility to qualify for incentives for new transmission construction projects in a timely manner and provide certainty that the utility will receive the transmission incentives. If a utility does not have certainty at the time it is considering new transmission construction that it will receive the 100 basis point adder, and instead must wait until the project enters commercial operation to determine whether the incentive is available, then the 100 basis point adder does not really act as an incentive to attract new investment.

EEI recommends that the Commission establish in the final rule that all transmission projects, including network upgrades required to interconnect generators, are eligible for a 100 basis point adder for new construction if the transmission project

meets one of three pre-established eligibility criteria.³ EEI proposes that the Commission adopt the following eligibility criteria in the final rule: (i) the transmission project is included in a regional transmission plan pursuant to an open and fair regional planning process acceptable to the Commission; (ii) the transmission project is approved by an appropriate state commission or state siting authority; or (iii) the transmission project is located in a National Interest Electric Transmission Corridor (“NIETC”) and the Commission or a relevant state authority has issued a permit for the construction or modification of the facility.⁴

1. THE TRANSMISSION PROJECT IS INCLUDED IN A REGIONAL TRANSMISSION PLAN PURSUANT TO AN OPEN AND FAIR REGIONAL PLANNING PROCESS ACCEPTABLE TO THE COMMISSION.

All projects that are included in a regional transmission plan that has been developed through an open and fair regional transmission planning process acceptable to the Commission should be eligible for the pre-approved ROE incentive for new transmission construction. The existence of such a plan provides substantial evidence that the project is needed and in the public interest. This would include RTO and ISO regional planning processes and processes managed by independent transmission administrators and other regional planning groups.

³ Eligibility of transmission owners that meet the criteria for the automatic 100 basis point adder should not make those transmission owners ineligible for other transmission incentives. Conversely, a transmission owner that does not meet one of the three criteria for automatic eligibility should not be foreclosed from demonstrating that it should receive the 100 basis point adder for new construction on other grounds.

⁴ As noted above, the issue of eligibility for a transmission incentive is not intended to affect decisions concerning the allocation of costs of facilities or the ability of customers to challenge those allocation decisions in separate proceedings.

2. THE TRANSMISSION PROJECT IS APPROVED BY AN APPROPRIATE STATE COMMISSION OR SITING AUTHORITY.

Automatic eligibility for an ROE transmission construction adder should also be available in circumstances where a state commission or state siting authority has approved construction of a transmission project within its state. Because state commissions or siting authorities have responsibility under state law for approving transmission projects, and their decisions are subject to appellate review under applicable state laws, the Commission should have confidence that projects approved by state commissions or siting authorities are in the public interest and entitled to incentive rates.

3. THE TRANSMISSION PROJECT IS LOCATED IN A NATIONAL INTEREST ELECTRIC TRANSMISSION CORRIDOR (NIETC) AND THE COMMISSION OR A RELEVANT STATE HAS APPROVED IT.

All transmission projects that the Commission has approved using its backstop siting authority under section 1221 of the 2005 Energy Policy Act should be automatically eligible to receive the transmission construction ROE adder, as should projects approved by a state commission or siting authority in an NIETC.

C. THE COMMISSION SHOULD ESTABLISH AN EXPEDITED CERTIFICATION PROCESS FOR PROJECTS THAT SATISFY THE ELIGIBILITY CRITERIA FOR THE ROE CONSTRUCTION ADDER.

The three categories of eligible projects listed above are intended to be objective indicators of eligibility. In all three cases, the fact that the projects are in the public interest has been determined objectively by competent expert authorities. The public will have had the opportunity to address whether the projects should be built through open and fair planning processes, under state law, or before this Commission.

As an alternative to requiring utilities to request the new transmission construction incentive in a full blown rate case, the Commission should adopt a certification process for the transmission construction ROE adder similar to the notice and certification process that the Commission has used to establish eligibility for other statutory and regulatory benefits, such as certification of generating facilities either as Qualifying Facilities under the Public Utility Regulatory Policies Act or as Exempt Wholesale Generators under the Public Utility Holding Company Act. The certification process for these generating facilities is primarily self-executing. The Commission should use a similar certification process here. This would provide notice to the Commission and interested parties that a transmission project developer intends to take advantage of the pre-approved incentive treatments for eligible projects. The certification filing should include the name of the project developer, a detailed description of the transmission project or projects for which the transmission incentive is sought, identification of which eligibility criterion is being used to make the project eligible for the incentive, and a factual demonstration that each project for which certification is sought is eligible under one of the qualification criteria in the final rule.

Because eligibility under the criteria set forth above should be self-evident in most cases, the Commission should not have to take any specific action on the certification filing, other than providing appropriate notice of the filing, and the filings should be deemed effective after 60 days unless the Commission rules otherwise before that time. Furthermore, these certification filings, which only demonstrate eligibility for the ROE incentive for new construction, should not provide parties opposed to the projects a second bite at the apple in terms of contesting disputed decisions by the

independent entities that have approved the projects. For example, some RTO transmission planning processes include mechanisms for appealing the contents of RTO regional transmission plans and for FERC approval of the project costs and recovery of those costs, as required under the Federal Power Act. Those processes should be followed, and if a plan becomes final under those processes, this certification filing should not provide a vehicle for complaining parties to repeatedly challenge the RTO's decision. The same would be true of decisions of state siting authorities, which are reviewable under state law, or the Commission's prior approval of a project.

The only issues that should be eligible for consideration in connection with these certification filings are protests that challenge whether a transmission project developer has demonstrated that its project meets one of the qualification criteria to be an eligible project.⁵ Such disputes should be rare given the objective nature of the three qualification criteria set forth above, and consistent with the objective of this proposal to provide certainty, the Commission should provide in the final rule that it will endeavor to resolve such disputes within 60 days of the date of the certification filing.

This certification process for eligible projects is intended to be dispositive of the project developer's right to the transmission construction ROE adder in the same manner and to the same extent that a declaratory order issued by the Commission would be dispositive. However, this mechanism would not replace the statutory requirement to

⁵ In a case where a utility chooses to include its incentive request as part of a general rate case, the Commission should summarily grant the incentives described herein if the utility demonstrates in its filing that the project(s) meet one of the three objective criteria. The utility should also be entitled to propose incentives be granted for new transmission projects that do not specifically meet the objective criteria for expedited decisions.

make a section 205 rate filing to implement the ROE adder, with appropriate review by the Commission of the inclusion of the cost of the project in rates as provided by the Federal Power Act.

D. THE COMMISSION SHOULD ADOPT A LIMITED SECTION 205 FILING PROCESS TO EXPEDITE ITS DECISIONS ON AUTOMATIC AND PRE-APPROVED INCENTIVES.

A section 205 rate filing will be required to implement the automatic incentives and the pre-approved construction ROE adder discussed above. For a public utility that has a formula transmission rate, the section 205 filing should be limited to including appropriate language in the formula rate allowing the utility to include the applicable automatic incentives and the transmission construction ROE adder for all eligible projects in its rates. The Commission should state in the final rule that any such formula rate section 205 filings are strictly limited to including the right to charge for automatic and pre-approved incentives for eligible projects and cannot be the basis for challenging any other aspect of the transmission provider's formula rates. Of course, formula rates would remain subject to challenge under section 206 of the Federal Power Act.

In cases where a public utility uses a stated transmission rate, it would of course be necessary for the utility to make a section 205 filing – either on a limited, project-by-project basis or as part of a general FERC rate case – to include in its rates the costs of new facilities, including the automatic and pre-approved rate incentives. However, again the Commission should establish by rule that if the utility makes a limited section 205 filing, the matters at issue are strictly limited to incorporating the automatic incentives and the pre-approved transmission construction ROE adder incentive into the existing rates, and the filing would not be subject to challenge with respect to any other

component of the filing company's transmission rates, including the existing cost-of-service methodology, base ROE, allocation methods, or rate design, which would remain subject to challenge under section 206 of the Federal Power Act. If the utility's stated transmission rate is a "black box" settlement without a specified rate of return on common equity, the limited section 205 filing also would include a base ROE for the project that would be modified to reflect the incentive ROE for the project. Such a limited filing should not result in a re-evaluation of the utility's entire cost of service, since doing so could result in a clear disincentive for the public utility to make incremental investment.

If a utility makes a general rate filing, the utility's eligibility for the automatic transmission incentives should not be at issue. The utility's right to the 100 basis point ROE adder should also not be at issue if a transmission project has previously been shown to meet one of the eligibility criteria for the ROE adder. If this demonstration has not previously been made, the ROE adder should be subject to challenge only on the ground that the project does not meet one of the three criteria.

II. FERC SHOULD NOT APPLY TIME LIMITS TO TRANSMISSION INCENTIVES.

Transmission incentives should not have time limits attached to them. Placing time limits on the applicability of transmission incentives reduces the effectiveness of the incentives and is counterproductive to the goal of encouraging investment in transmission and membership in transmission organizations.

As noted in the NOPR, the Secretary of Energy's Advisory Board determined that one of the requirements for investment in the transmission grid is a regulatory policy that

“provides a return that makes investment in transmission a reasonable option, considering other available investment options.” (NOPR, P 1, footnote omitted.) Because transmission is such a long-lived investment, applying transmission “incentives” as a short-term shot in the arm usually will do little to achieve the goal of making such investment economically attractive. Moreover, EEI can conceive of no rationale basis for ceasing a particular ratemaking policy in the middle of the investment recovery period. Therefore, transmission incentives for new construction should continue for the life of the transmission project in order to provide a consistent return on that investment.

III. SECTION 205 RATE FILINGS TO RECOVER THE INCREASED COSTS OF TRANSMISSION SERVICE SHOULD BE SUBJECT TO NO MORE THAN A ONE-DAY SUSPENSION.

A. FIVE-MONTH SUSPENSIONS ARE NOT NECESSARY BECAUSE THE COMMISSION’S REFUND POLICY PROTECTS CUSTOMERS AGAINST PAYING RATES THAT ARE FOUND NOT TO BE JUST AND REASONABLE.

A policy that provides for a one-day suspension of rate increases aimed at recovering transmission costs should be an integral part of the Commission’s transmission policy to encourage transmission investment. Under section 205(e) of the Federal Power Act, the Commission has the authority to order refunds with interest in the event it suspends the effective date of a filed rate increase and subsequently determines that the filed rates are not just and reasonable. Therefore, the Commission’s refund authority fully protects customers against paying rates that are allowed to go into effect after a nominal suspension if the rates are subsequently found to be excessive. On the other hand, if the Commission suspends the effective date of a filed rate increase for five months, as it can do under section 205(e), then the filing utility can never recover any

portion of that rate increase for that five-month period, even if the Commission ultimately determines that all or a portion of the requested increase is just and reasonable.

One of the most effective incentives in the Commission's proposed transmission incentive policy is to enable utilities to begin recovering costs associated with transmission facilities, including increased operating and maintenance costs, as soon as possible. Suspending a rate filing that includes transmission costs and related expenses for five months is clearly inconsistent with both the Congressional and Commission policy of encouraging transmission investment. Suspensions result in a utility's losing the opportunity to obtain revenues for a period of time, and those lost revenues can never be recouped by the utility. If, on the other hand, the filed rates are allowed to become effective after a nominal suspension period, the utility obtains the revenues to cover its increased costs. Customers remain protected because they will receive refunds with interest of any rates that subsequently are determined to be unjust and unreasonable.

B. FERC'S SUSPENSION POLICY SHOULD ENCOURAGE TRANSMISSION INVESTMENT.

The Commission's rate suspension policy for electric rate filings under section 205 has been to suspend the filing for the maximum five-month period where the preliminary analysis indicates that more than 10% percent of the proposed rate may be unjust and unreasonable. *West Texas Utilities Co.*, 18 FERC ¶ 61,189 at 61,374 (1982) ("*West Texas*"). The Commission's policy of suspending rate filings for the maximum period is at odds with the Energy Policy Act of 2005 and section 219 of the Federal Power Act, which mandate implementation of transmission incentives to encourage investment in transmission facilities. This is because the prospect of a five-month

suspension of a utility's entire rate increase if it seeks to recover costs associated with the transmission facilities serves as a significant disincentive to the construction of new transmission facilities or incurring additional transmission costs. Thus, as discussed in EEI's initial comments, EEI encourages the Commission to suspend rates that include new transmission for only a nominal period, *i.e.*, one day.

The Commission's suspension policy allows it to implement suspensions with flexibility. In *West Texas* at p. 61,374-75, the Commission stated that it recognized the need to use discretion in imposing a five-month suspension because a maximum suspension could lead to "harsh and inequitable results." *West Texas*, 18 FERC at p. 61,374-75. The Commission also stated:

Where a small deviation in a highly judgmental factor within our preliminary analysis, such as return on common equity, would constitute the difference between a one day or a five month suspension, we shall retain the administrative flexibility to take this into account. Also, in cases in which increased revenues do not appear to be excessive, but other, extraordinary factors indicate that wholesale customers may suffer irreparable harm absent a five month suspension, we shall order a maximum suspension. Likewise, extraordinary circumstances might dictate a shorter suspension regardless of the amount of increase.

West Texas at p 31,375. In *Allegheny Power System Operating Cos.*, 111 FERC ¶ 61,308, P 51 (2005), the Commission held that, where it had "urged transmission owners to move from stated rates to formula rates, and where customers would also benefit from the incentive provided by these rate changes to the PHI TOs to commence construction of RTEP upgrades," a shorter suspension period was warranted.

If the Commission does not revise its suspension policy, as requested above, EEI urges the Commission to convene a technical conference for the specific purpose of developing a more reasonable suspension policy that will encourage transmission

investment. The goal of a revised suspension policy is to ensure that utilities will not be penalized by five-month suspensions for meeting their responsibility to provide reliable transmission service or when they are responding to the Congressional and Commission mandates to invest in new transmission facilities. Such a policy also will benefit consumers because it will further encourage investment in new transmission.

IV. CONCLUSION

WHEREFORE, EEI respectfully requests that the Commission consider these supplemental comments and adopt transmission incentive policies that are consistent with them. If the Commission has any questions relating to these comments, please contact either me, Russell Tucker at (202) 508-5519, or Ed Comer at (202) 508-5615.

Respectfully submitted,

- signature -

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