

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Promoting Transmission Investment
Through Pricing Reform

Docket No. RM11-26-000

COMMENTS OF THE
ELECTRICITY CONSUMERS RESOURCE COUNCIL
(ELCON)

The Electricity Consumers Resource Council (ELCON) appreciates the opportunity to comment on the Commission's May 19, 2011 *Notice of Inquiry* (NOI) on transmission investment incentives.¹ ELCON is also a signatory to and supportive of joint comments filed by an *ad hoc* coalition of end users, public power systems, state public utility commissions, state consumer advocates, and rural electric cooperatives (the "Joint Commenters"). In these comments, ELCON wishes to highlight certain topics addressed by the NOI that are of particular significance to ELCON members.

In recent years, the Commission has approved incentives on a routine basis for numerous transmission projects, without substantial evidence that incentives are actually necessary for the project to be viable. ELCON recognizes that transmission incentives may be appropriate in certain limited circumstances. Unfortunately, the NOI does not evidence strong action to address the fundamental deficiency in the Commission's current, *ad hoc* and unprincipled approach to transmission incentives -- the lack of a requirement for applicants to demonstrate clear, tangible benefits which exceed the projected costs of the project.

ELCON is the national association representing large industrial consumers of electricity. ELCON member companies produce a wide range of products from

¹ 76 Fed. Reg. 30, 869 (May 27, 2011)

virtually every segment of the manufacturing community. ELCON members operate hundreds of major facilities and are consumers of electricity in the footprints of all organized markets and other regions throughout the United States.

ELCON COMMENTS

In the five years since FERC issued its current transmission incentives policy in Orders 679 and 679-A, it has become clear that the policy has failed to adequately protect consumer interests. Projects which were already slated to be built have received incentives, including instances in which the transmission provider was obligated to build by contract or tariff, in which the project was necessary to comply with NERC reliability standards, or projects that were not otherwise different in any material respect from other projects routinely considered through a regional planning process. The routine approval of large transmission incentives has contributed substantially to the alarming escalation in the costs of transmission service that ELCON members located in every region of the country have experienced.

Usage of the nexus test under Orders 679 and 679-A² has given transmission investors and developers the benefit of the doubt and has resulted in approval of incentives for numerous projects that would not pass muster under a properly applied “cost causation” analysis. In light of the previous five years of experience, the time has come for FERC to reconsider its decision not to adopt a “but for” test, which would have required a showing that the project would not otherwise be built “but for” the granting of incentives. In cases in which a project is otherwise going to be built, there is simply no need for FERC offer additional incentives. In such cases, the transmission sponsor will be assured of an adequate return through normal approval and ratemaking procedures. Incentives will, at best, speed completion of a project, but there

² In Order 679, FERC found that “we do require applicants to show some nexus between the incentives being requested and the investment being made, i.e., to demonstrate that the incentives are rationally related to the investments being proposed.” According to Order 679-A, “In evaluating whether the applicant has satisfied the required nexus test, the Commission will examine the total package of incentives being sought, the interrelationship between any incentives, and how any requested incentives address the risks and challenges faced by the project.” In practice, few requested incentives have been denied.

is scant real world evidence supporting that proposition, and typically no analysis of the cost of incentives compared to the limited benefits of the slightly faster completion of a project.

Adoption of a “but for” test would help the Commission distinguish between routine and non-routine projects. ELCON believes that the Commission should make routine projects (defined as projects that are necessary in the normal course of the utility’s business) ineligible for incentives absent unique mitigating circumstances, and should predicate any approval of incentives on a symmetrical application of rewards and penalties. There should be a rebuttable presumption that there is no need for incentives if a project developer has: (1) voluntarily agreed to fund network upgrades that interconnection customers would otherwise be required to fund under applicable Large Generator Interconnection Procedures, or (2) elected to forego alternative funding sources, e.g., project participation funds from other utilities or LSEs in the region.

The current transmission incentives policy also suffers from serious flaws in what types of incentives are offered. Incentives should be tailored to the risk profile of the project to optimally align the interests of project developer and consumers. Routine, low risk projects should not be eligible for incentives. Projects with intermediate risk should be eligible for risk-reducing rate treatments such as CWIP and guaranteed recovery of the cost of abandoned projects. Projects with a high level of risk (e.g., projects that are built under extraordinary circumstances) should be eligible for return-enhancing rate treatments such as ROE adders that are commensurate with the level of risk. In other words, we recommend a rebuttable presumption against return-enhancing incentives in the absence of a demonstration of extraordinary risk. In no circumstances should a project receive both return-enhancing rate treatments and risk-reducing rate treatments. This sort of double-dipping results in excessive (and unnecessary) returns to project sponsors without a clear or tangible benefit to consumers.

Historically, the offering of rate incentives was an extraordinary step that was justified only when necessary to remedy unusual circumstances that might hinder the

construction of facilities that would be beneficial to rate payers. But, in practice, the overly lax standards for receipt of rate incentives have resulted in the shifting of the financial risks associated with transmission project to consumers, while at the same time granting project sponsors an enhanced return on the risk-shielded rate base. Instead of using a “carrot and stick” approach to encourage the construction of transmission, the Commission has in effect adopted a “carrot and carrot” approach, with rate payers footing the bill.

ELCON members recognize that investment in transmission infrastructure is necessary to maintain reliability and to resolve congestion in certain transmission corridors. However, FERC’s transmission incentives policy has led to approval of incentives for projects that clearly are not necessary to resolve reliability and congestion issues. The NOI suggests nothing more than the further entrenchment of current practices, reducing the threshold for transmission incentives to a token barrier. In doing so, FERC would be forsaking its statutory duties to ensure that all rates are “just and reasonable.”

COMMENTS ON QUESTIONS POSED IN THE NOI

ELCON supports the responses set out in the Joint Commenter’s comments to the NOI’s specific questions and offers the following additional comments on the general topics as outlined in the NOI.

A. General Principles: Questions 1 through 9

Section 219 did not alter the Federal Power Act’s generally applicable “just and reasonable” standard. Section 219 only added a requirement for FERC to implement an incentive policy to encourage the development of transmission that will benefit consumers by improving their reliability of service or reducing the cost of delivered power by reducing congestion. In other words, Section 219 does not supplant the

requirement that all rates must be “prudently incurred”³ and comply with principles of “cost causation.” FERC must, as always, assess the costs and benefits of proposed investments, and determine whether the costs are justified by commensurate benefits.

The problem with the current incentive policy, as implemented in Order 679 and 679-A, is that it fails to demand sufficient accountability from applicants. Applicants are not required to quantify benefits, and frequently the incentive rate treatments are not even tied to actual performance. This lack of accountability is highlighted by FERC’s decision not to adopt a “but for” test for receipt of incentives, which would help distinguish between routine, and non-routine projects. Because FERC did not adopt such a test, it is difficult to determine after the fact whether any particular project would have been built in the absence of the incentives awarded. But it is clear that whatever speculative benefits may have resulted from transmission incentives approved by FERC, they have been far outweighed by the excessive costs charged to rate payers.

A cornerstone of the “just and reasonable” standard is the “cost-causation” requirement, which requires that all approved rates reflect to some degree the costs actually caused by the consumer who must pay them. Although the Commission need not allocate costs with exacting precision, it may depart from the principle of cost causation only in extraordinary circumstances and for a limited purpose. A rate design that results in some ratepayers subsidizing the service of others is *prima facie* inconsistent with cost-causation and presumptively invalid. The claim of “generalized system benefits,” such as amorphous reliability improvement, is insufficient to justify regionalized charges; rather, there must be a tangible, non-trivial benefit supported by substantial evidence in the record.

The principle of “cost causation” is well established by both court cases and Commission cases. The long line of “cost causation” cases trace their origin to *Colorado Interstate Gas Co. v. Federal Power Commission*, a seminal 1945 Supreme Court decision, which stated, in a opinion frequently cited by FERC, that “[t]he problem [to be

³ See e.g., *Public Utilities Comm’n of the State of California v. FERC*, 24 F.3d 275 (D.C. Cir. 1994); *Cities of Batavia, et al. v. FERC*, 672 F.2d 64 (D.C. Cir. 1982).

addressed by a rate case] is to allocate to each class of the business its fair share of the costs.”⁴ The courts consistently have continued to develop the principle of “cost causation” in subsequent electricity cases. As the D.C. Circuit has explained, although “just and reasonable” provides a “spartan” statutory standard, “FERC and the courts have added flesh to these bare statutory bones, establishing what has become known ... as the ‘cost-causation’ principle.”⁵ The cost causation principle is the “touchstone in any legal analysis of FERC-approved rate schemes,” and it requires “that all approved rates reflect to some degree the costs actually caused by the customer who must pay them.”⁶ Reiterating the point made by the Seventh Circuit, the D.C. Circuit has stated that compliance with the cost causation principle must be evaluated “by comparing the costs assessed against a party to the burdens imposed or benefits drawn by that party.”⁷ The court in *Midwest ISO* described FERC’s cost causation principle as “requir[ing] that all approved rates reflect to some degree the costs actually caused by the customers who must pay them.... Not surprisingly, we evaluate compliance with this unremarkable principle by comparing the costs assessed against a party to the burdens imposed or the benefits drawn by that party.”⁸ Although FERC need not “allocate costs with exacting precision,” it may depart from the principle of cost-causation only in extraordinary circumstances and for a limited purpose.⁹ A rate design that results in some ratepayers subsidizing the service of others is prima facie inconsistent with cost-

⁴ 324 U.S. 581, 588 (1945).

⁵ *K N Energy, Inc. v. FERC*, 968 F.2d 1295, 1300 (D.C. Cir. 1992).

⁶ *Id.*; see also *Village of Bethany v. FERC*, 276 F.3d 934, 937 (7th Cir. 2002) (“The overriding policy concern in a ratemaking proceeding is to establish rates that require each customer to bear a fair and proportional share of . . . costs.”).

⁷ *Midwest ISO Transmission Owners*, 373 F.3d 1361, 1368-69 (D.C. Cir. 2004).

⁸ *Id.* (Citations omitted); see also, *United Distribution Cos. v. FERC*, 88 F.3d 1105, 1188-89 (D.C. Cir. 1996) (“[c]ost causation correlates costs with those customers for whom a service is rendered or a cost is incurred”); and *Cities of Riverside and Colton, California v. FERC*, 765 F.2d 1434, 1439 (9th Cir. 1985).

⁹ *Midwest ISO Transmission Owners*, 373 F.3d at 1369; *Transmission Access Policy Study Group v. FERC*, 225 F.3d 667, 707 (D.C. Cir. 2000); see also *Sithe/Independence Power Partners, L.P. v. FERC*, 285 F.3d 1, 5 (D.C. Cir. 2002) (remanding to FERC to explain why it did not apply “a different method of refunds, based more closely on cost-causation principles”).

causation and presumptively invalid.¹⁰ Cost causation principles also govern choice of rate structure.¹¹

The Commission has described its “long standing policy” on utility cost allocation in these words: “Properly designed rates should produce revenues from each class of customers which match, as closely as practicable, the cost to serve each class or individual customer.”¹² FERC has treated as black-letter law the “cost-causation” principle that customers using a facility or service, or benefiting from a facility or service, must pay their fair share of the costs of the facility or service.¹³ Implicit in the cost-causation analysis is the principle that each “customer pay[s] for the service [it] receive[s] and do[es] not subsidize service rendered on behalf of others.”¹⁴ Moreover, the Commission has found that a claim of “generalized system benefits” is insufficient to justify charges, there must be a tangible, non-trivial benefit supported by the record.¹⁵ The Commission also has acknowledged that the principle of fairly allocating

¹⁰ *Sea Robin Pipeline Co. v. FERC*, 795 F.2d 182, 188 (D.C. Cir. 1986); *Nat’l Ass’n of Sec. Dealers, Inc. v. SEC*, 801 F.2d 1415, 1420 (D.C. Cir. 1986) (“Avoidance of cross-subsidization of services is a legitimate, non-arbitrary reason for requiring difficult cost allocations.”).

¹¹ See e.g., *Midwest Independent Transmission System Operator, Inc.*, 118 FERC ¶ 61,209 (2007) (Applying cost causation analysis to proposed revisions to MISO’s Open Access Transmission and Energy Markets Tariff that included special cost allocation for regionally beneficial projects, which were defined in part as facilities with voltages of 345 kV or higher) and *Illinois Commerce Comm’n v. FERC*, 576 F.3d 470, 476 (7th Cir. 2009).

¹² *New Dominion Energy Cooperative*, 122 FERC ¶ 61,174, P 41 (2008), citing *Alabama Electric Cooperative, Inc. v. FERC*, 684 F.2d 20, 27 (D.C. Cir. 1982).

¹³ See, e.g., *California Power Exchange Corp.*, 106 FERC ¶ 61,196, P 17 (2004), (the “well-established principle of cost causation requires that costs should be allocated, where possible, to customers based on customer benefits and cost incurrence”). See also *CAISO*, 103 FERC ¶ 61,114, P 26 (“[w]hile this fundamental idea of matching costs to customers is often referred to in terms of cost causation, it has also often been described in terms of the costs which ‘should be borne by those who benefit from them’” (quoting *Gulf Power Co. v. FERC*, 983 F.2d 1095, 1100 (D.C. Cir. 1993))).

¹⁴ *Empire State Pipeline and Empire Pipeline, Inc.*, 116 FERC ¶ 61,074 at P 115 (2006).

¹⁵ See e.g., *FPL Energy Marcus Hook, L.P. v. PJM Interconnection, L.L.C.*, 123 FERC ¶ 61,289 at P 50 (2008) (noting that “[e]very addition to the system could be characterized as providing some possible intangible system benefit by adding transmission capacity redundancy”); *Transcontinental Gas Pipe Line Corp.*, 112 FERC ¶ 61,170, 61,924-25 (2005).

transmission costs among those who use and benefit from transmission facilities fully applies to RTO transmission rates.¹⁶

The current transmission incentives policy fails to comply with the cost-causation principle. Incentives have been and continue to be approved for projects without substantial or credible evidence that rate payers will actually realize a benefit from the grant of the incentive. If a project is already going to be built, rate payers are guaranteed to receive the benefits of the project. In these circumstances, rate payers receive no additional benefit from the award of incentive treatment, only more costs. In a number of cases, identified in the Joint Commenters' comments at pages 18-28, transmission project developers have been granted rate incentive packages that appear to substantially exceed the incentives that would result in just and reasonable rates. To prevent such wasteful and unnecessary incentive awards, FERC should at a minimum require applicants for transmission incentives to clearly demonstrate that there is a measurable benefit (in the form of increased reliability or lower delivered costs) to rate payers that is likely to result from the grant of the incentives, and that these benefits materially outweigh the costs of the incentives.

B. Section 219(a) Statutory Threshold and Additional Goals: Questions 10 through 18

In addition to the general requirement of showing clearly identifiable benefits, which outweigh the costs of the project, the Commission should adopt a general policy that acceptance or approval of a transmission project under a Commission-approved regional process is a prerequisite for receipt of incentives. Approval of a project as part of a regional planning process should not by itself qualify the applicant to receive transmission rate incentives; the regional planning processes vary widely in their approach and may not focus on the issues that are most important to Section 219 analysis. But conditioning incentives on approval in a regional planning process will, at

¹⁶ See *Alliance Companies*, 94 FERC ¶ 61,070, 61,311-13; *Midwest Independent Transmission System Operator, Inc.*, 104 FERC ¶ 61,105, PP 50-51; *Ameren*, 105 FERC ¶ 61,216, PP 32, 57; *Midwest Independent Transmission System Operator, Inc.*, 106 FERC ¶ 61,262, P 6 n.10 (2004) (approving the Going Forward Principles).

the very least increase the likelihood that the project will deliver benefits to ratepayers sufficient to justify the incentives. By contrast, if a project is not evaluated under a regional transmission planning process (whatever its shortcomings), there is no basis for comparing the asserted benefits of the project with benefits that would be available under potential alternatives.

In terms of information or studies the Commission should consider, the Commission should require each applicant to provide: (1) an engineering assessment demonstrating that any project will enhance reliability, and (2) an economic analysis demonstrating that the proposed project is likely to reduce the cost of delivered power. The analysis should reflect the full estimated cost of the proposed project, including the impact of any proposed return-enhancing incentives. The Commission should not accept generalized assertions of positive impacts on reliability or congestion as sufficient satisfaction of the Section 219 statutory standards.

The Commission should also require a project sponsor to file with the Commission a notification if the scope of a project changes significantly after the Commission has made a determination to grant incentives, describing in detail the changes in the project and the anticipated consequences of those changes for the project's effects on reliability and/or cost of delivered power. The Commission should establish procedures to allow interested parties to evaluate and comment on the impacts of the changes in the project on the project's satisfaction of the statutory prerequisites for incentives. Based on the notification of changes to the project and the comments submitted by interested parties, the Commission should reevaluate the appropriateness of incentives in light of the reported changes. Although this reevaluation may give rise to some uncertainty regarding the continued availability of incentives, it would be inconsistent with the relevant statutory standards to permit developers to continue to receive incentives granted on the basis of an original project description for a substantially modified project.

The Commission should also adopt a rebuttable presumption that there is no need for incentives where a project developer: (1) voluntarily agrees to fund network

upgrades that interconnection customers would otherwise be required to fund under applicable Large Generator Interconnection Procedures, or (2) elected to forego alternative funding sources, e.g., project participation funds from other utilities or LSEs in the region.

C. Order No. 679 Nexus Test: Questions 19 through 26

The questions posed by Commission are based on the assumption that the Commission should continue to use the nexus test. But the ultimate objective of Section 219 is to benefit consumers through increased reliability or lower delivered power costs (resulting from reduced congestion). The nexus test is flawed, in that it fails to require applicants to demonstrate tangible benefits that exceed the expected costs of the incentives sought. As the Commission has previously stated:

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.¹⁷

In place of the nexus test, the Commission should adopt a “but for” test, requiring applicants to show that the award of incentives is necessary for the project to be completed. In other words, if the project is viable without incentives, incentives should not be awarded, absent extraordinary circumstances.

D. Interrelationship of Incentives: Questions 27 and 28

¹⁷ 1992 Policy Statement on Incentive Rates, at p. 61,586 (internal citations omitted).

There are two primary types of incentive rate treatments: risk-reducing and return-enhancing. The Commission policy should make clear that risk-reducing and return-enhancing incentives will not be granted for the same project. Granting both risk-reducing and return-enhancing incentives for the same project is duplicative and unnecessary to achieve the goals of Section 219.

E. The Role of Cost Estimates: Questions 29 through 32

Return-enhancing incentives should be applied only to the project developer's estimated costs. The opposite approach, permitting applicants to receive incentives above and beyond the estimated costs, has the perverse result of discouraging project developers from mitigating risks and reducing project costs where possible.

F. Individual Incentives – Incentive ROE Adder: Questions 33 through 48

ELCON recommends a rebuttable presumption against return-enhancing incentives in the absence of a demonstration of extraordinary risk. The incentives policy should recognize that project risks vary across a continuum from very low risk (i.e., routine projects) to intermediate and high risk. The choice and use of specific incentive mechanisms should be tailored on a case-by-case basis to the level of risk. Projects with high levels of risk (e.g., projects that are built under extraordinary circumstances) would be eligible for return-enhancing rate treatments such as ROE adders that are commensurate with the level of risk. Indeed, the Commission has previously found that the most compelling case for incentives is a new project that presents special risks or challenges, rather than a routine investment made in the ordinary course of expanding the system to provide safe and reliable transmission service.¹⁸

Incentives that augment return should only be considered for truly innovative projects, or for those projects with uncommon risks that are not effectively addressed by

¹⁸ Order No. 679-A at P 23.

risk-reducing incentives. Given the obligations of many transmission providers under existing tariffs to plan for and build transmission sufficient to maintain reliability and service to customers, it makes little sense to increase returns as a reward for doing something the provider is already required to do.

G. Individual Incentives - Abandonment: Questions 49 through 56

Recovery of abandoned plant costs for transmission projects that are found to be needed in inclusive, regional planning processes, may be appropriate in some circumstances. But applicants who chose to forego participation in such a regional planning process must assume the risk that a project will later be deemed unnecessary by a permitting authority, and ratepayers should not be required to fund such a developer's decision to follow a more speculative approach. Finally, the Commission should carefully scrutinize the applicant's claim as to why abandonment was beyond its control.

H. Individual Incentives - Construction Work in Progress (CWIP) in Rate Base: Questions 57 through 62

Risk-reducing rate treatments such as CWIP should not be adopted as "routine" rate treatments that apply to all utility investments. The Commission should continue to apply on case-by-case basis the "used and useful" standard, and incentives such as CWIP and guaranteed recovery of the cost of abandoned projects should be approved sparingly. The courts have approved the usage of CWIP even though, a strict interpretation of the "used and useful" requirement might "foreclose allowing CWIP in rate base under any circumstances."¹⁹ The approval of CWIP as an exception to the "used and useful" requirement, however, is premised on the understanding that it was justified by a public interest rationale. Due to the unique characteristics of each transmission project, ELCON does not believe that FERC cannot adequately ensure the public interest is served through a general rulemaking. Only by looking at the facts of

¹⁹ *Mid-Tex Electric Cooperative v. FERC*, 773 F.2d 327, 332 (D.C.Cir.1985).

each application on a case-by-case basis will FERC be able to make certain that each project will provide benefits commensurate to the costs, and that the incentives are well tailored to the specific economic realities of the project.

I. Other Incentives: Questions 63 through 74

It has been ELCON's experience that accelerated depreciation is not on the whole a useful or beneficial incentive. It does not target pre-project completion cash flow limitations or the risk of abandonment, because it can be claimed in rates only after a facility has been constructed and placed into service. It fails to address regulatory lag for the same reason. More importantly, although it is often presented as a device that accelerates payments but does not change the ultimate cost to ratepayers, it does not necessarily have that effect in practice. The Commission has previously approved collection of a "management fee" for depreciated facilities once the original investment was recovered to provide an "incentive" for continued efficient operation. If the owner can simply move to collect more money after the facilities are depreciated, consumers will pay more in the long run. In addition, accelerated depreciation unfairly shifts to today's consumers the costs of facilities with useful lives that will benefit ratepayers for many years after the accelerated depreciation has elapsed. An incentive that may well cost ratepayers more in total costs and may shift costs inappropriately among ratepayer cohorts, without significantly mitigating the risks faced by transmission providers, is little more than a return enhancer. However, there are other incentives also designed to increase return to the provider, and there is little need for multiple methods for doing so. To the extent a return enhancer is appropriate at all, there are other ways to accomplish that result without shifting costs inappropriately.

NOTICES AND COMMUNICATIONS

Notices and communications with regard to these proceedings should be addressed to:

John P. Hughes
Vice President, Technical Affairs
ELECTRICITY CONSUMERS RESOURCE
COUNCIL
1111 Nineteenth Street, NW, Suite 700
Washington, DC 20036
Email: jhughes@elcon.org
Phone: (202) 682-1390

W. Richard Bidstrup
CLEARY GOTTLIEB STEEN &
HAMILTON LLP
2000 Pennsylvania Avenue, NW, Suite 900
Washington, DC 20006
Email: rbidstrup@cgsh.com
Phone: (202) 974-1500

Respectfully submitted,

/s/ W. RICHARD BIDSTRUP

W. Richard Bidstrup
Mark W. Walker
CLEARY GOTTLIEB STEEN & HAMILTON LLP
2000 Pennsylvania Avenue, N.W., Suite 900
Washington D.C. 20006
Counsel for ELCON

Dated: September 12, 2011

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary of this proceeding.

Dated at Washington, D.C.: September 12, 2011

/s/ MARK W. WALKER

Mark W. Walker