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FERC's Electric Transmission Incentives Policy: Impacts and Emerging Issues

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AGENDA

- Background on FERC's Transmission Incentives Policy
 - FPA Section 219 Requirements
 - FERC's Order No. 679
- Developments and Trends Under Order No. 679 Incentives Policy
 - Pre-2012 Policy Statement Trends
 - Post 2012 Policy Statement Trends
- Recent Notice of Inquiry in Docket PL19-3
 - Issues and Potential Impacts of FERC's Questions in Docket PL19-3
- Takeaways, Questions and Comments

BACKGROUND ON FEREC'S TRANSMISSION INCENTIVES POLICY

FPA Section 219: Directed FERC Rulemaking

- Establish incentive-based (including performance-based) rate treatments for the transmission of electric energy in interstate commerce by public utilities **for the purpose of benefitting consumers** by:
 - Ensuring **reliability**; and
 - **Reducing** the **cost** of delivered power by reducing transmission congestion
- FERC must ensure incentive-based rates meet the “**just and reasonable**” standard contained in FPA Sections 205 and 206

FERC Order No. 679 Regulations: Incentive-Based Rate Treatments

- Project-specific incentive-based rate treatments for public utilities:
 1. ROE to attract new investment in transmission facilities
 2. 100% recovery of prudently incurred construction work in progress (CWIP) in rate base
 3. Recovery of prudently incurred pre-commercial operations costs
 4. 100% recovery of prudently incurred costs of abandoned facilities
 5. Use of hypothetical capital structures
 6. Accelerated depreciation used for rate recovery
 7. Deferred cost recovery (for utilities with retail rate freezes)
 8. Any other incentives approved by FERC pursuant to 18 CFR § 35.35 that are just and reasonable
- ROE adder for public utilities that join Transmission Organizations; recovery of prudently incurred costs for transmitting utilities or electric utilities associated with joining
- Incentives for Transcos: (1) ROE adder; and (2) Adjustment to book value of assets sold to Transcos to remove disincentives re: accelerated depreciation on capital gains tax liabilities
- Recovery of prudently incurred costs for: (1) mandatory reliability standards compliance; and (2) transmission infrastructure development within National Interest Corridors

FERC Order No. 679 Regulations: Showings Required by Applicants

Statutory Test

Applicant proves project:

- (1) Ensures reliability; *or*
- (2) Reduces cost of delivered power by reducing congestion



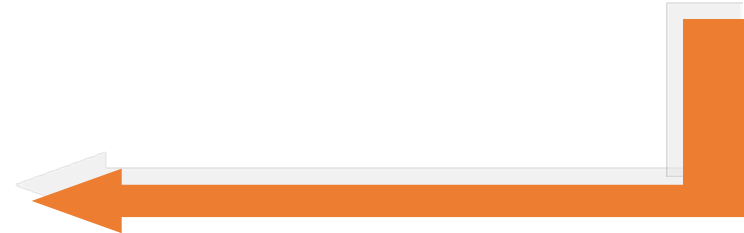
Statutory Test

- Rebuttable Presumption
 - (1) Results from regional planning process
 - (2) Approved by state authority
- Independent Demonstration
- National Interest Corridor



Nexus Test

Applicant proves *total* package of incentives is tailored to address demonstrable risks or challenges faced in undertaking the project



Commission determines appropriate incentives

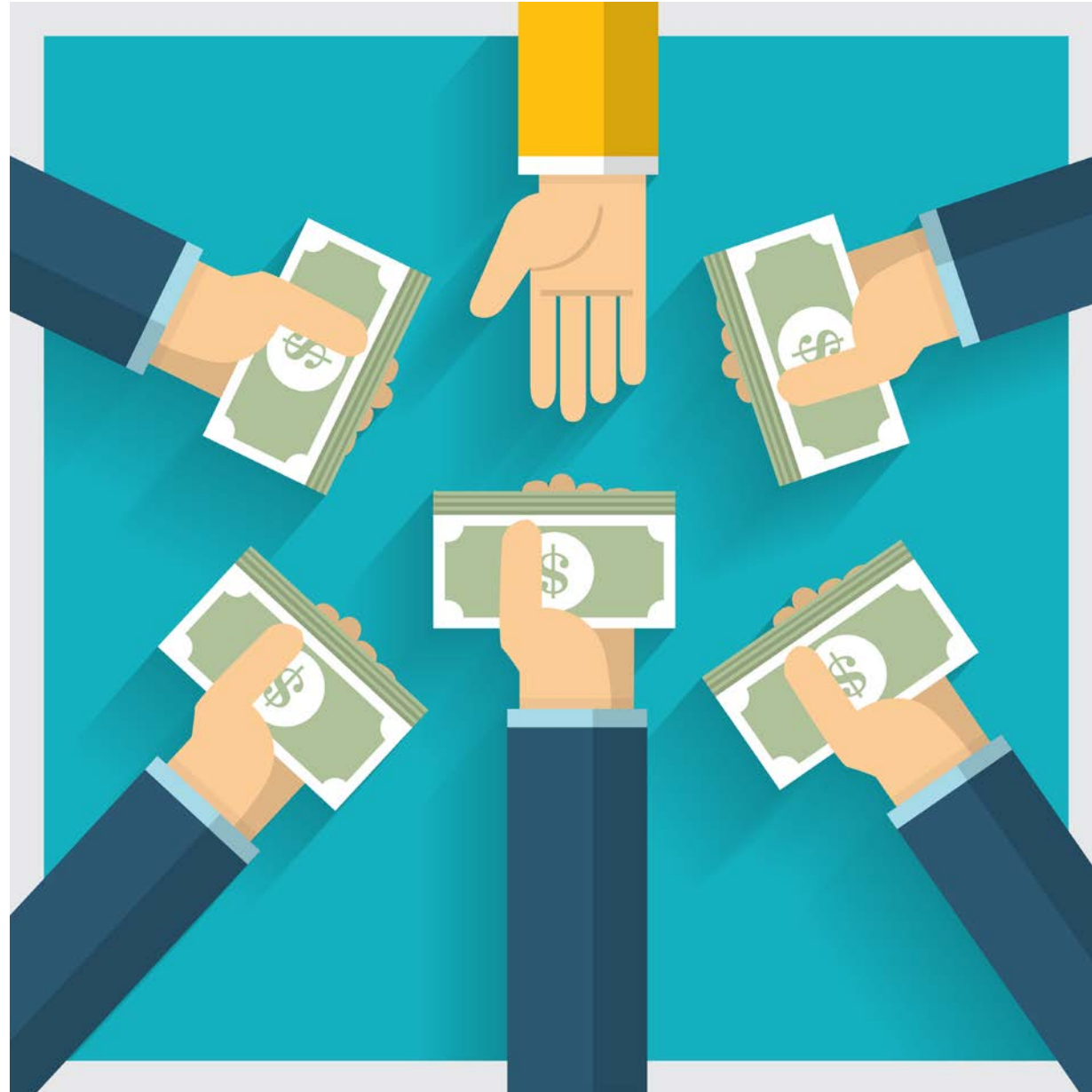


Rates with incentives subject to just and reasonable test

Order No. 679 Incentives to Public Power

- While incentives (other than RTO adder) not directly available to most public power entities, FERC will entertain (and has granted) incentive requests when public power participates with jurisdictional entities as part of a proposal
- Non-public utilities “could be covered by a public utility's incentive rate proposal by a separate agreement between the public utility and a non-public utility”
- FERC left open possibility of permitting non-jurisdictional transmitting utilities incentives under FPA Section 211A

Developments and Trends Under Current Incentives Policy: Pre- and Post- 2012 Policy Statement



Pre-2012 Policy Statement: Trends and Statistics

- 2012 Policy Statement reported review of over 85 applications representing over \$60 billion in potential transmission investment
- October 2011 statistics:
 - The projected rate base for projects granted incentives went from approximate \$3.8 billion in 2006 to **\$63.7 billion** in October 2011
 - \$370 million approximate annual cost of ROE adders for incentive projects by October 2011 (not including RTO adders on non-incentive projects)
- FERC used routine/non-routine analysis as a proxy for the Nexus Test
- Risk-reducing incentives (e.g., CWIP + Abandoned Plant) also routinely granted
- Public policy grants when applicants failed to meet Order No. 679

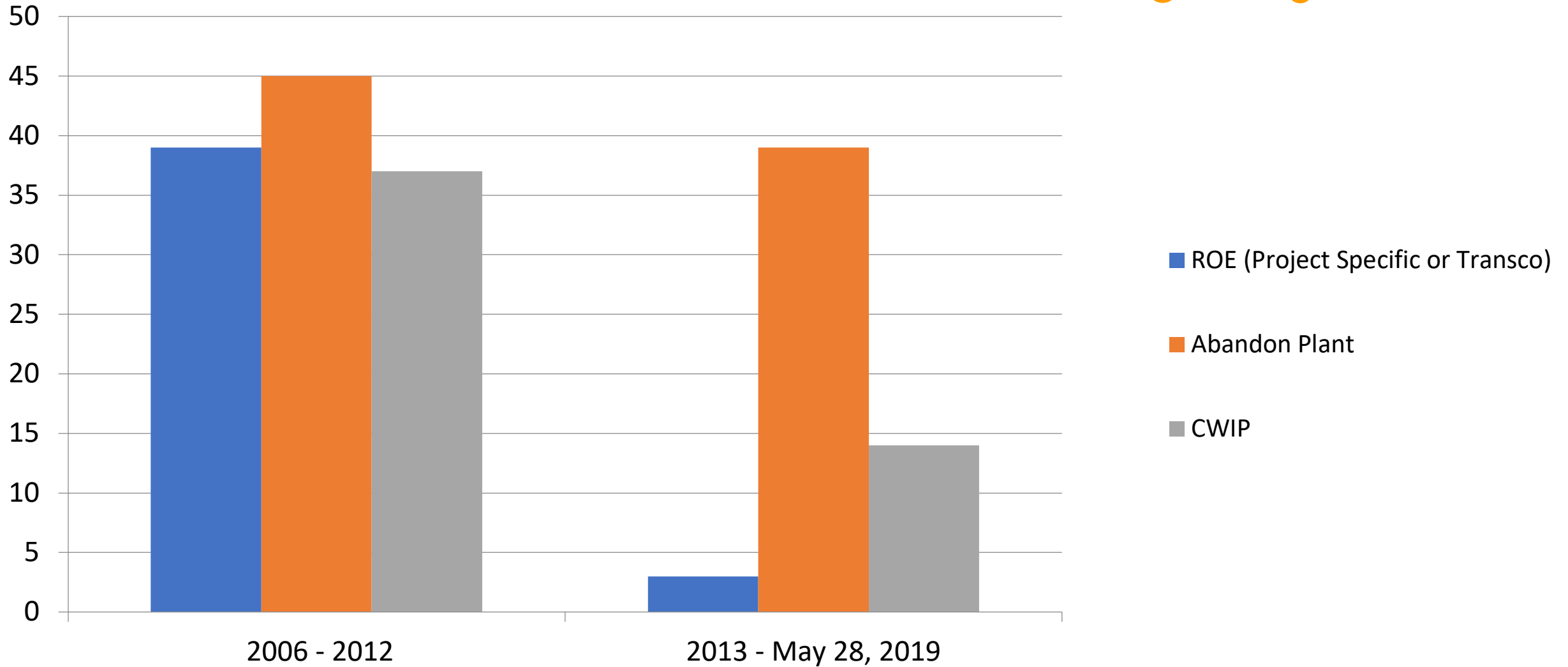
APPA-led Joint Comments in: Docket RM11-26 NOI

- Sought revisions to FERC's incentive policy, including:
 - Limiting incentives to needed projects that would not have been built but-for the grant of such incentives
 - Favor risk-reducing over return-enhancing incentives
 - Limit return-enhancing incentives to project estimate
 - Phase out/reduce RTO adder for existing members
 - Require demonstration, particularly if project has not undergone planning process: (1) measurable benefit to consumers if specific incentives granted; (2) causal relationship between incentive and benefits; (3) benefits materially exceed costs

2012 Policy Statement: Positive Changes

- Evaluate *total* package of incentives being sought and investment being made; not routine v. not routine
- Shifted focus to reliance on
 - **risk-reducing incentives** (e.g., CWIP, abandoned plant, & regulatory asset treatment) over **return-enhancing incentives** (e.g., ROE adders)
- An applicant seeking a project-specific ROE adder is expected to demonstrate: (1) the project risks/challenges are not already addressed in the base ROE or through risk-reducing incentives; (2) use of risk mitigation steps during project development; (3) consideration of project alternatives; and (4) a commitment to limit incentive to a cost estimate
- Eliminated the ROE adder for use of an advanced transmission technology

Orders Granting Certain Incentives: 2006-2012 v. 2013-2019



2012 Policy Statement: Issues Left Unaddressed

- No phase-out/down of RTO membership adder
- No cost-benefit metrics for grant of incentive
- ROE adder for Transco formation
- No sunset dates for incentives
- No post in-service date review of cost-benefit for continued receipt of incentives
- Difficulty in tracking projected v. actual costs and costs of incentives awarded

Some Concerns Raised Post-2012 Policy Statement

- Multiple bidders for the same project could require ratepayers to pay costs for the abandonment of projects if the RTO ultimately selects another developer/project
- Grant of incentive under Section 205 when applicant does not meet Order 679 requirements; e.g., to place non-incumbents on a level playing with incumbents in Order 1000 competitive solicitation process
- Concerns with regulatory asset incentive for acquisition of existing assets
- RTO participation adder should not be applied where participation not voluntary
- Allowing yet-to-be-formed affiliates able to utilize the same formula template and same requested incentives would obstruct need to independently review base ROE and projects
- Abandoned plant incentive should be limited to costs incurred from the date of the grant of the incentive, not costs incurred before the incentive was requested

FERC March 21, 2019 Notice of Inquiry in Docket PL19-3: Issues and Potential Impacts

Impetus for PL19-3 Notice of Inquiry

- Significant developments in how transmission is planned, developed, operated, and maintained
- Issuance of Order No. 1000
- Changes in the generation mix
- Number of new resources seeking transmission services
- Shifts in load patterns
- Increased emphasis on the reliability of transmission infrastructure
- Record compiled in various incentives proceedings
- Ensure FERC continues to satisfy FERC's obligations under FPA Section 219
- Initial comments due June 26, 2019; Reply comments due August 26, 2019

105 Qs in PL19-3 NOI: Including on Approach and Project/Applicant Type

- **Approach/Threshold Qs:** *e.g.*,
 - Replace the threshold from risks and challenges to benefits of a project?
 - Automatically apply incentives instead of engaging in a case-by-case review?
 - Rebuttably presume risk-reducing incentives for regional planning process projects?
 - Consider risks in calculating base ROE *and* project-specific ROE for risks and challenges?
- **Project/Applicant Type Qs:** *e.g.*,
 - Physical and cybersecurity?
 - Projects with “flexible characteristics”?
 - Existing transmission grid improvements?
 - Location-constrained
 - Transcos
 - Resiliency enhancements?
 - Reliability/economic?
 - Advanced technology?
 - Reliability/economic?
 - Non-incumbents?

PL19-3 NOI Qs on Non-Public Utilities

- **Non-Public Utility Qs:** *e.g.*,
 - Barriers to non-public utilities' ownership of transmission facilities?
 - Grant incentives to promote joint ownership arrangements with non-public utilities?
- **APPA's 2011 Joint Comments**
 - FERC should require an applicant for incentive rate treatment to demonstrate:
 - (1) that it has considered joint ownership; and
 - (2) why joint ownership either was infeasible or would not suffice to overcome the risks associated with the development

PL19-3 NOI Qs Related to Planning and on Implementation and Mechanics

- **Implementation and Mechanics:** *e.g.*,
 - Limited in duration?
 - Revisited if there is a material modification?
 - Additional data on incentives? Metrics for measuring effectiveness of incentives?
 - Condition incentives on a cost-benefit ratio?
- **Planning-Related Qs:** *e.g.*,
 - Existing transmission facility improvements?
 - Non-incumbents?
 - Interregional transmission projects?
 - Non-RTO/ISO regions?
 - Costs of unsuccessful Order No. 1000 proposals recoverable through regulatory asset/deferred pre-commercial cost recovery?

Is There a Demonstrated Need for More Incentives?

- Transmission investment has increased since 2006
- Need for empirical evidence that existing incentives policy is ensuring reliability/reducing cost (“But-for Test”)
- Need for empirical evidence that needed transmission is not being and that the grant of incentives is the appropriate solution to meet Section 219 objective of benefitting consumers
 - FERC Staff 2017 Transmission Metrics Report: “As noted in the 2016 Report, it is difficult to assess whether the electric industry is investing in sufficient transmission infrastructure to meet the nation’s needs and whether the investments made are more efficient or cost-effective.” <https://www.ferc.gov/legal/staff-reports/2017/transmission-investment-metrics.pdf>
- Concerns associated with transmission development may be tied to transmission planning processes or state policies outside of FERC’s control

Threshold/Process Issues: Some Issues to Consider

- Continue to apply a case-specific Section 219 benefits + Nexus test?
 - Rebuttable presumption for projects that undergo regional transmission planning processes?
 - Does focus on expected benefits increase likelihood that routine projects will qualify?
 - Does automatic grant of certain incentives balance investor/customer needs?
- Should projects that do not undergo regional transmission planning process be eligible?
- Is current preference for risk-reducing over return-enhancing incentives working?
- If benefit not realized, should there be penalties/revocation of incentives/relaxation of the prudence burden on customers?
- Should non-transmission alternatives or technologies be eligible?
- Does mandatory regional cost allocation impact need or demonstration of benefits?

Project/Applicant/Incentive Type:

Some Issues to Consider

- Should projects that are needed for core business objectives receive incentives?
 - Are reliability, resiliency and security investments part of a utility's core business objectives?
- Should FERC incentivize development of interregional projects or is a region-specific assessment needed?
- Is an RTO adder needed/appropriate for continued membership or where required by statute/contract?
- Should abandoned plant incentives be limited to date after FERC grants incentive?
- Should improvements to existing transmission facilities receive incentives?
- Do non-RTO regions, non-public utilities, Transcos, or non-incumbents warrant separate incentives?
- What types of projects warrant return-enhancing adders?

Takeaways

- Section 219 still in effect to incentivize transmission infrastructure development
- Various proceedings can influence ultimate impact of incentives policy on public power transmission customers and ownership
 - *E.g.*, PL19-4 (ROE NOI), AD19-12 (Cyber and Physical Security Practices), EL17-45 (Rehearing of PG&E Self-approved projects), ER14-2529 (CAISO adder remand from 9th Circuit), ER19-1553 (So. Cal. Edison request for 600 basis point increase to ROE for wildfire risks), AD16-18 (Competitive Transmission Development Processes), etc.
- Provide input in response to NOIs, and remain active in FERC proceedings, planning processes, and legislative processes

Questions/Comments

Thank you!

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APPENDIX – ADDITIONAL BACKGROUND

Transmission Incentive Treatments Required by FPA Section 219

- Promote capital investment in enlargement, improvement, maintenance, and operation of transmission facilities for reliable and efficient transmission and generation of electricity – regardless of the ownership of the facilities
- Provide ROEs that attracts new investment in transmission facilities, including related transmission technologies
- Provide incentives for joining a Transmission Organization (e.g., RTO/ISO) to transmitting utilities and sellers of electric energy to extent of FERC's jurisdiction
- Encourage advanced transmission technologies and other measures to increase the capacity and efficiency of existing transmission facilities and improve their operation
- Allow recovery of prudently incurred costs of: (1) mandatory reliability standards compliance; and (2) transmission infrastructure development within National Interest Corridors

FERC Order No. 679 Regulations: FERC Form 730

- Annual report required from public utilities that received incentives for projects
- The following information must be filed:
 - Actual transmission investment in dollars for year
 - Projected incremental investments for next five years
- For projects above \$20 million: (1) Expected completion date; (2) Percent completion; and (3) Reasons for any delays
- Purpose of Form is not to provide a quantitative measure of the consumer benefits that result from transmission infrastructure investment

2012 Policy Statement: Projects that May Satisfy “Risks and Challenges” for ROE Adder

- Relieve chronic or severe grid congestion that has had demonstrated cost impacts to consumers;
- Unlock location-constrained generation resources that previously had limited or no access to the wholesale electricity markets; or
- Apply new technologies to facilitate more efficient and reliable usage and operation of existing or new facilities
 - Not an exhaustive list

PL19-3 Qs: Approach to Incentives Policy

- Questions Focus on whether risks and challenges test remains appropriate
 - Asks whether incentives to address risks and challenges are an appropriate proxy for the expected benefits identified in Section 219
 - Asks if it is appropriate to consider risks in calculating base ROE *and* project-specific ROE for risks and challenges
- Asks whether FERC should instead evaluate incentive requests based on project's potential to achieve benefits related to reliability/congestion
 - Asks if general principles or bright line criteria should be used
 - Asks if benefit-to-cost estimates should be used; including to condition/revoke incentives
 - Asks if incentives should be awarded automatically or case-by-case
- Asks if project characteristics should be used as a proxy for expected benefits
 - (e.g., persistent needs, interregional, location-constrained, technologies)

PL19-3 Qs: Incentive Objectives

- Rather than focus on tests of reliability/congestion benefit or risks and challenges, asks if project or benefit characteristics should be used, and if so:
 - How project benefits or characteristics can be quantified or measured (e.g., general principles, bright line tests, or application of specific criteria)
 - How projects/benefits can be incentivized
 - The Legal basis, extent, and determination of nature of incentives
- Asks how many ROE basis points would be appropriate for particular incentives
- Asks if/how incentives other than ROE adders could encourage project benefits or characteristics

PL19-3 Qs: Project/Applicant Characteristics

1. Reliability benefit/service (NERC standards, planning criteria, frequency/voltage support, ramping)
2. Economic efficiency benefits (reducing congestion, access to additional generation)
3. Geographic areas with persistent needs (e.g., long-term congestion or reliability issues)
4. Flexible transmission system operations (e.g., line rating precision, power flow control, energy storage technologies)
5. Security (physical, cyber-security)
6. Resilience (ability to withstand and reduce magnitude/duration of disruptive events)
7. Improving existing transmission facilities (e.g., advanced management software or technologies)
8. Interregional projects
9. Unlocking location-constrained generation resources
10. Ownership by non-public utilities or joint ownership
11. Order No. 1000 projects (e.g., automatic grant of risk-reducing incentives, promote nonincumbent)

PL19-3 Qs: Existing ROE Incentives

- Asks if existing ROE adders remain relevant and appropriate for:
 - RTO Participation
 - (1) if revise incentive; (2) if provide CWIP in rate base or abandoned plant on automatic basis for all members of RTO; (3) what ROE adder level is appropriate; (4) if project-specific instead of entire rate base; and (5) if voluntary participation should remain a requirement?
 - Transcos
 - (1) if sufficient benefits to merit incentives; (2) what demonstration to require; (3) if affiliates eligible; (4) if on project-specific basis; and (5) for developed instead of purchased projects?
 - Advanced Technologies
 - (1) why so few requests; (2) do NERC standards increase risk of violations; and (3) other incentives for deployment of advanced technologies?

PL19-3 Qs: Existing Non-ROE Incentives

- Continue to provide incentives such as CWIP and pre-commercial costs as expense or regulatory asset?
- Should risk-reducing incentives be granted automatically to certain types of projects?
- Should the costs of unsuccessful Order No. 1000 proposals be recoverable through regulatory asset/deferred pre-commercial cost recovery incentives?
- Hypothetical capital structures: (1) what types of entities should be eligible (e.g., new, small); (2) should it be authorized for yet-to-be formed affiliates; (3) has it been effective in reducing overall cost of debt rendering capital structure more predictable; (4) should it extend beyond construction period?
- Should FERC reduce abandonment plant costs to 90% to avoid unnecessary risks and how should FERC evaluate if costs of an abandoned facility were prudently incurred?
- Does accelerated depreciation provide meaningful benefits; should a generic depreciation period be used or case-by-case?

PL19-3 Qs: Mechanics and Implementation

- **Duration of incentives:** Should an automatic sunset provision apply (e.g., after a material change to a transmission project, or if estimated project benefits never materialize)?
- **Reporting on benefits:** Require reporting on project's expected benefits over a particular time period?
- **Automatic v. case-by-case:** Grant incentives automatically once threshold criteria are reached as opposed to case-by-case basis?
- **Combination of incentives:** Develop a new framework to determine the appropriate level and combination of incentives (e.g., formulaic or case-by-case)?
- **ROE limits:** Whether an upper limit for total ROE should be established or whether pre-determined ranges should be established for ROE incentives
- **Measuring Incentives:** What metrics should be used to measure effectiveness of incentive? Whether Form 730 should be expanded to all public utility transmission providers? Additional information should be required? Project-by-project information?