



# TRANSMISSION SERVICE: FERC ISSUES TRICKLE DOWN TO RATE MANAGERS

Large Public Power Council  
Rate Members Seminar

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# Testing The Waters: The Latest Trends In ISO Membership





# FERC'S Days Of Trying To Force Utilities Into RTOS Are Over

- FERC seems to no longer consider ISOs to be the only way to achieve regional planning and open markets.
  - ✓ Standard Market Design died an ugly death.
  - ✓ FERC no longer seems to be prepared to use "undue discrimination" as a basis for pressuring utilities to join ISOs.
- In Order No. 890, FERC rejected proposals to require the creation of "pseudo ISOs" by requiring security-constrained economic dispatch in non-ISO markets.
  - ✓ It stated that requiring "Day 2" markets is not necessary to cure undue discrimination.
- However, utilities, including public power, are inching closer to having ISOs provide services to them.

## Pressures Are Growing To Adopt Regional Solutions To Transmission Issues

- In Order No. 890, FERC adopted regional planning requirements that may achieve many of the benefits of ISO-based regional planning.
- The need for dramatic increases in transmission construction has increased the pressure to adopt regional planning.
- NERC's reliability standards – and FERC's authority to enforce them against all users, owners and operators of the bulk power system – have placed increased emphasis on compliance issues.
- Public utilities are feeling increased pressure from FERC's aggressive oversight and enforcement of tariff, OASIS and Standards of Conduct obligations.

## Interest In Alternatives To Full RTO Membership Is Growing

- Independent Coordinators of Transmission Service
- Midwest ISO's "RTO-Lite" options
- Regional transmission arrangements that are not RTOs or ISOs

## Independent Transmission Service Coordinators – Midamerican/Transerv

- MidAmerican turned over the processing of transmission service requests to TranServ.
  - ✓ It did so to settle enforcement action by the FERC concerning tariff administration and allegations of preferential treatment for its merchant function.

## Independent Transmission Service Coordinators – Duke Power/MISO

- Duke Power hired Midwest ISO to perform OASIS functions following two audits that found violations of the OATT and the Standards of Conduct.
  - ✓ Duke retained all other transmission functions.
  - ✓ FERC required the service coordinator to be financially and operationally independent from Duke.
  - ✓ Duke's transmission customers objected to the extra costs involved, but FERC rejected their arguments.

## Independent Transmission Service Coordinators – Entergy/SPP

- Entergy contracted with Southwest Power Pool to be its transmission service coordinator following intense FERC scrutiny and numerous allegations of violations of Order No. 888 and the Standards of Conduct.
  - ✓ Entergy turned over more control of its functions than Duke did in order to take advantage of FERC's offer in Order No. 2000 to allow "non-traditional pricing" of transmission service.

## Independent Transmission Service Coordinators – Entergy/SPP continued

- ✓ FERC required SPP to have complete control over all aspects of processing transmission requests; it refused to allow Entergy veto power over SPP's contractors; it required stakeholder review of SPP's and Entergy's actions; and it required Entergy to compensate SPP in a way that would not compromise SPP's independence.
- ✓ FERC limited Entergy's right to terminate the agreement with SPP in order to ensure SPP's independence.

## Midwest ISO's Four "RTO Lite" Options

- Midwest ISO has discussed with MAPP Members alternatives to full RTO membership that would provide them some of the benefits of RTOs.
- Midwest ISO recently posted a proposed Module F to its Tariff that offers four levels of service to entities that do not want to place their transmission systems under the Midwest ISO Tariff:
  - ✓ Reliability Coordination Service
  - ✓ Interconnected Operations and Congestion Management Service
  - ✓ Energy Market Coordination Service
  - ✓ Transmission and Energy Markets Integration Service

# MISO's Proposed Reliability Coordination Service

- MISO does the following:
  - ✓ monitors customer transmission facilities to ensure their operational reliability;
  - ✓ provides network modeling;
  - ✓ provides operations engineering services such as evaluating system adequacy and security, performing voltage collapse studies, load flow studies and stability studies;
  - ✓ monitors ACE and system frequency deviations;
  - ✓ addresses reliability concerns using generator redispatch, reconfiguration of facilities (including modification of transmission and generation outage schedules), TLRs, load shedding and other actions;
  - ✓ supports power system restoration activities;
  - ✓ develops a regional reliability plan and monitor customer compliance with NERC and RRO reliability standards.

## MISO's Proposed Interconnected Operations And Congestion Management Service

- The customer and MISO will exchange real-time and projected operating data, SCADA data, EMS models, ATC, AFC, transmission reservations, load and generator data and outage schedules.
- They also will coordinate transmission service requests to ensure that they do not affect each other's flowgates and use reciprocal redispatch and TLRs to manage congestion.
- The Kentucky utilities that left MISO take very similar service from MISO.

## MISO's Proposed Energy Market Coordination Service

- MISO will integrate the customer's load and resources into the MISO market.
- MISO will manage congestion using Security Constrained Economic Dispatch, including generation redispatch.
- MISO will be the Reliability Coordinator for the customer.
- Customers pay locational marginal prices and marginal losses.
- Customers are eligible for ARR and FTRs.
- Customers are required to sign MISO's Balancing Authority Agreement and participate in the Ancillary Services Market.

## MISO's Proposed Energy Market Coordination Service continued

- Customers also may ask MISO to establish an OASIS page, calculate ATC/AFC and process transmission service requests.
- Customers do not provide transmission service on a "license plate" basis. They provide service under their own OATTs.
- They also are not subject to RECB charges or revenues.

## MISO's Proposed Transmission And Energy Markets Integration Service

- MISO will treat the customer as if it were a Transmission Owner under the MISO Tariff, but the customer will not have to sign the Transmission Owners' Agreement.
- The customer will be fully integrated into the MISO Market, will provide transmission service on the same terms as MISO Transmission Owners and will be subject to RECB charges.
- This service appears largely to be responsive to Duquesne Light, which had expressed a desire to leave PJM but not sign the MISO TO Agreement.

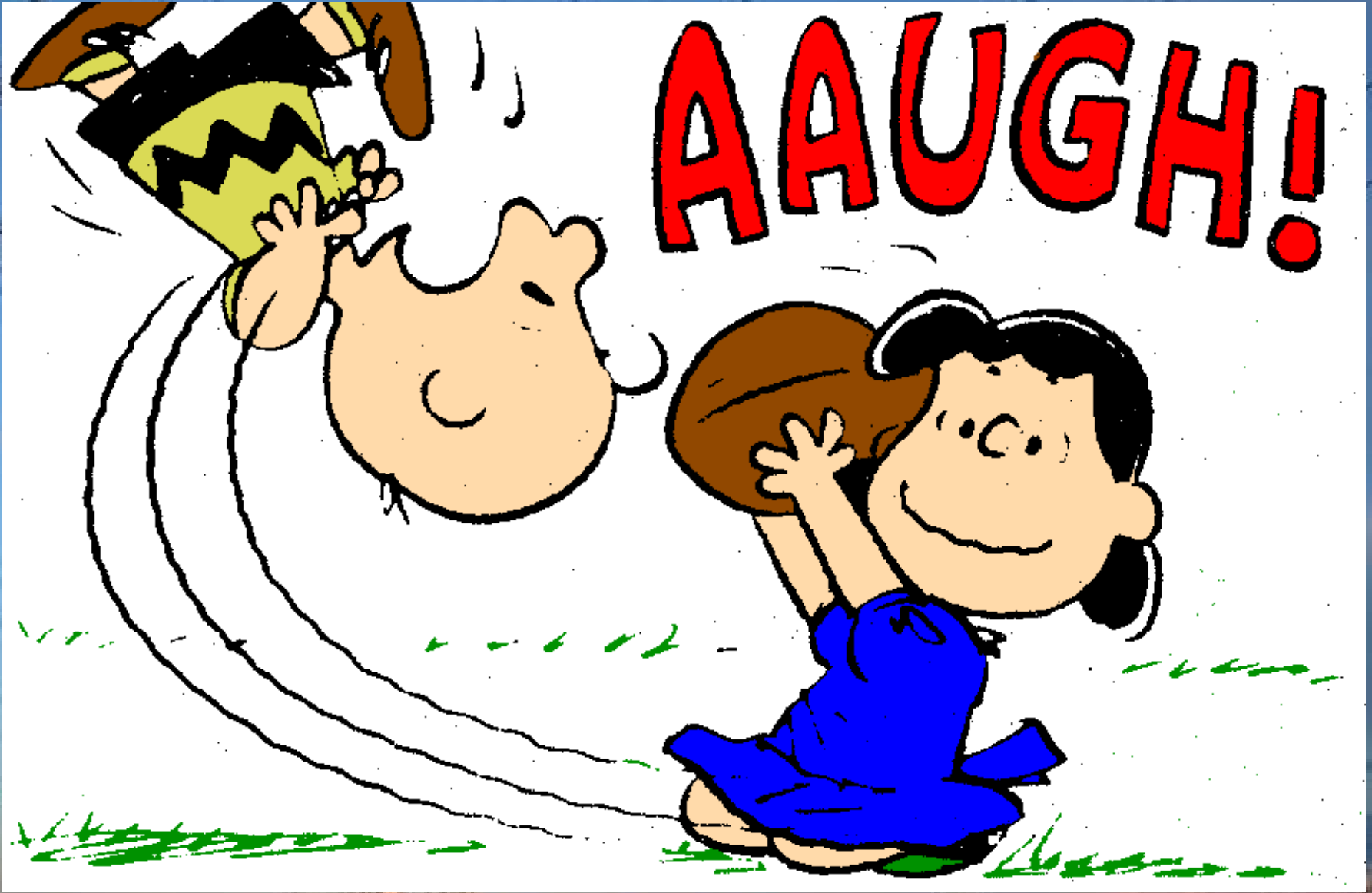
## Implications For Rates Managers

- While each of the services currently being offered provides benefits to customers, they all will cost more than the services that utilities are currently providing themselves.
- Transmission-related cost increases may be particularly steep if a utility chooses Energy Market Coordination Service or Market Integration Service.
  - ✓ Customers taking both services will be subject to marginal losses, congestion costs, and several MISO schedules providing for recovery of administrative costs.

## Implications For Rates Managers continued

- ✓ Customers taking Energy Market Coordination Service will also have to pay for MISO “drive-out” service when generators in MISO deliver energy to the market in excess of their loads; and may have to pay for transmission service for differences between generation and load within the MAPP region.
- ✓ Market Integration Customers will be subject to RECB charges.
- The cost increases should be offset by congestion hedges (ARRs/FTRs), reductions in the price of energy, and some decreases in administrative costs.
- Reliability of service also should improve as TLRs are reduced, but the value of increased reliability is hard to quantify.

# FERC Transmission Incentives: Has Lucy Pulled The Football Away From Charlie Brown – Again?



## Energy Policy Act of 2005

- Section 219 of EPAC 2005 required the FERC to adopt regulations providing for incentive-based rate treatments for transmission service for the purpose of benefitting consumers by ensuring reliability and reducing the cost of delivered power by reducing transmission congestion.

## Energy Policy Act of 2005 continued

- Congress required the regulations to:
  - ✓ promote reliable and economically efficient transmission and generation by promoting capital investment in transmission;
  - ✓ provide a return on equity that attracts new investment;
  - ✓ encourage deployment of new transmission technologies;
  - ✓ allow recovery of prudently incurred costs associated with mandatory reliability standards and construction of transmission;
  - ✓ provide incentives for joining RTOs;
  - ✓ result in “just and reasonable” rates.

# FERC'S Order No. 679: Promoting Transmission Investment Through Pricing Reform

- FERC held that an applicant must demonstrate that:
  - ✓ the facilities for which it seeks incentives ensure reliability or reduce the cost of power by reducing transmission constraints;
  - ✓ there is a nexus between the incentive being sought and the investment being made;
  - ✓ the resultant rates are just and reasonable and not unduly discriminatory.
- FERC did not require utilities to demonstrate that the facilities would not be built without the incentives.

## FERC'S Order No. 679: Promoting Transmission Investment Through Pricing Reform continued

- FERC also refused to require a cost benefit analysis for the incentives.
- FERC stated that incentives may vary or be denied for routine reliability-related investment.
- FERC allowed recovery of 100% of Construction Work in Progress instead of the then-effective limit of 50%.
- Utilities that are members of RTOs are permitted to earn an additional 50 basis points on their ROEs.

# FERC'S Order No. 679: Promoting Transmission Investment Through Pricing Reform continued

- Utilities also are permitted to:
  - ✓ recover pre-commercial operations costs;
  - ✓ establish rates based on hypothetical capital structure;
  - ✓ recover accelerated depreciation on new facilities;
  - ✓ recover 100% of prudent costs for facilities that are abandoned or canceled due to factors beyond their control instead of 50%;
  - ✓ defer recovery of costs until the end of retail rate moratoriums;
  - ✓ recover incentives for new technologies.

## Allegheny Energy And American Electric Power Orders – FERC's Love Affair With Incentives

- On the same day that it issued Order No. 679, FERC issued declaratory orders responding to Allegheny's request for approval of incentive rates for a new 330 mile 500 kV line; and AEP's request for approval of incentives for a new 550 mile 765 kV line.
- FERC held that the utilities had shown a nexus between their proposed construction and the requested incentives, but deferred decisions on the justness and reasonableness of the transmission rates until the utilities make Section 205 filings.

## Allegheny Energy And American Electric Power Orders – FERC's Love Affair With Incentives continued

- FERC stated that Allegheny was not obligated to build the line and that it would cost three times as much as its current net plant in service.
- FERC granted both utilities a return at the high end of the zone of reasonableness, to be determined later; approved 100% of CWIP in rate base; approved the expensing of pre-commercial operations costs; and stated that it would approve recovery of 100% of Allegheny's prudent costs if its project is abandoned for reasons outside Allegheny's control.
- On rehearing, FERC rejected arguments that allowing Allegheny 100% of CWIP in rate base and recovery of pre-commercial operations costs reduced Allegheny's risk and justified a lower ROE.

## Pacificorp: Just A Lover's Quarrel?

- In September 2006, the FERC suspended PacifiCorp's request for a transmission rate increase for five months.
- PacifiCorp requested a 200 basis point incentive for \$1.1 billion in expenditures to replace aging facilities and expand its infrastructure that would increase its net transmission plant by 15%.
- FERC approved the continuation of a 200 basis point ROE adder and 15 year depreciable life for the Path 15 project, which it had approved in 2002.

## New England Transmission Owners: Storm Clouds on the Horizon

- In October 2006, FERC issued an order affirming and reversing an Initial Decision on transmission incentives.
- The Initial Decision had a 100 basis point ROE incentive because it was not needed to obtain financing or speed completion of transmission projects.
- The Commission reserved, stating that the Initial Decision had held that an incentive should be granted only if transmission would not be constructed without it.
- Commission Kelly dissented, asserting that there was no evidence that the incentive would help alleviate impediments to new construction.

## Duquesne Light: Sleeping on the Couch

- Duquesne requested incentives for a new transmission line to enhance reliability, plus new technology to increase the capability of existing 345 kV lines. It stated that the new investment is 76% of its current net plant in service.
- Duquesne requested a 150 basis point ROE incentive, 100% CWIP in rate base, expensing of pre-commercial operations costs and recovery of prudent costs if the project is abandoned for reasons beyond its control.
- In February 2007, FERC held that the project is not routine and that it involves significant regulatory and technological risk, and it approved the requests for 100% of CWIP in rate base and recovery of pre-commercial operations costs and abandonment costs.

## Duquesne Light: Sleeping on the Couch continued

- FERC limited the ROE incentive to 100 basis points because the other incentives reduced its regulatory risk.
- Commissioner Kelly dissented, stating that the projects are routine and that incentives should be limited to projects that are in the public interest but that are not required to maintain reliability.
- Commissioner Wellinghoff agreed with the ROE incentive for projects that had been approved through its RTEP process but dissented on FERC's conditional approval of incentives for the remainder of its project.

## Commonwealth Edison: The Honeymoon Is Over!

- In June 2007, FERC denied ComEd's request for a declaratory order concerning incentives for its transmission construction program.
- ComEd requested a 150 basis point adder and recovery of 50% of CWIP in rate base for \$345 million in new construction, of which \$48 million had already been placed in service.
- FERC held that ComEd had not demonstrated that there is a nexus between the project and the incentives because it appeared that the annual investment in the projects was roughly equivalent to its average annual expenditures and because the new project was only 14% of its current net plant in service.

## Commonwealth Edison: The Honeymoon Is Over! continued

- FERC also pointed out that ComEd's statement that it needed the incentive to attract capital was inconsistent with its recent retirement of long-term debt and that there was no evidence that incentives were needed to maintain ComEd's credit quality or maintain cash flow.

## Transmission Rates – Recent Developments

- FERC also appears to have abandoned its previous policy of accepting transmission formula rates for filing with nominal suspensions.
- In August, FERC suspended AEP's formula rate for five months. Issues that probably resulted in the suspension include its requested base ROE of 11.4% and its use of year-end plant balances instead of 13-month average balances.
- In September, FERC suspended Arizona Public Service's formula rate for five months. FERC set for hearing the proposed ROE of 11.3% and end-of-year plant balances. It also set for hearing the proposed inclusion of 50% CWIP in rate base.

## Transmission Rates – Where Are We Now?

- Utilities that thought EAct 2005 and Order No. 679 promised “regulatory candy” clearly were wrong.
- FERC will carefully evaluate request incentives, and it will interpret Order No. 679 narrowly.
- Commissioner Kelly may never again fall in love with any incentive.
- Commissioner Wellinghoff will continue to insist on technological innovation as a criterion for eligibility for incentives.

# Innovative Transmission Technology



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