UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Promoting Transmission Investment	**:**	**Docket No. RM06-4-000**
through Pricing Reform	**:**	

NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES' COMMENTS ON PROPOSED RULEMAKING

National Association of State Utility
Consumer Advocates

Suite 101
8300 Colesville Road
Silver Spring, MD 20910
301-589-6313

Dated: January 11, 2006

TABLE OF CONTENTS

Page

TABLE OF CONTENTS, cont'd

Page

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Promoting Transmission Investment through Pricing Reform	**:** **:**	**Docket No. RM06-4-000**

NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES' COMMENTS ON PROPOSED RULEMAKING

EXECUTIVE SUMMARY

The National Association of State Utility Consumer Advocates (NASUCA) is a national association of consumer advocate offices with members in 42 states and the District of Columbia. NASUCA's members are charged by their respective state laws with the responsibility to represent consumers in utility proceedings before state and federal regulatory commissions and courts.

NASUCA members support the level of transmission infrastructure investment required to relieve congestion and provide reliable, economically efficient transmission service at just and reasonable rates. However, the proposed NOPR goes well beyond the requirements of the Energy Policy Act of 2005 by failing to take into account the Act's explicit reminder that such rates remain subject to the just and reasonable requirements of the Federal Power Act. NASUCA members therefore do not support the proposed NOPR in its current form as a means of achieving these goals. NASUCA urges the Federal Energy Regulatory Commission ("Commission" or "FERC") to consider that transmission owners are public utilities and <u>already</u> have an affirmative obligation to provide safe, adequate, efficient and reliable service at just and reasonable rates. There has been no consideration of how present transmission rates for any transmission owner are not currently just and reasonable. In fact, NASUCA maintains that the much-lamented decline in transmission investment in the 1990s resulted from the overall uncertainty regarding the restructuring of the electric industry.

<u>NASUCA opposes the specific incentive proposals contained in this NOPR.</u> In general, it is not adequately shown in the NOPR how the proposals are a just and reasonable approach to further stimulating transmission investment and improvements. The cost of any such widespread incentives will likely offset any benefits the Commission anticipates it will achieve through this Rulemaking. Moreover, the proposed incentives may constitute an unjustified multi-billion dollar giveaway of consumer money.

Broad-based incentives are misguided for two principal reasons. First, broad-based incentives are not necessary. The Commission cites the *EEI Survey of Transmission Investment: Historical and Planned Capital Expenditures* (1999 – 2008) (2005) ("EEI Survey") as basis for the determination that wide-spread (and potentially large) incentives for new transmission construction are required. Specifically, the EEI Survey states that an annual increase in transmission investment of $1 billion is necessary to ensure system reliability over the next two decades.[1] Ignored by the Commission in this conclusion is the fact that the EEI Survey also states that since 1999 significant

---

[1] *Id.* at 3; and Energy Policy Act of 2005: Hearings before the House Subcommittee on Energy and Commerce, 109th Congress, First Sess. (2005) (Prepared Statement of Thomas R. Kuhn, President of EEI).

transmission investment occurred and that by 2006, annual expenditures will reach about $6 billion: $1 billion per year greater than the Commission opines is adequate. This historic investment, as well as planned investments in transmission infrastructure, has occurred without any ratemaking incentives.

Second, it should be noted the Commission did not provide any cost/benefit analyses of the proposed incentives. The potential cost to consumers of the ROE adders alone may outweigh any realized benefits. In a previous Docket, i.e., *Proposed Policy For Efficient Operation And Expansion of Transmission Grid,* Docket No. PL03-1-000 ("NOPPS" or "Policy Docket"), NASUCA conservatively calculated the total consumer cost of the NOPPS at over $ 13 billion (approximately $711 million per year for the 19 year time horizon of the Policy Docket). See Affidavit of Matthew I. Kahal.[2] In short, the potential cost of the NOPPS' incentives offsets the potential benefits from RTOs as calculated in the Commission's own study. Applying the analysis to this proceeding, the risk in the Commission's proposed incentives is that the ROE adders (including enhanced ROE and ROE incentives for joining an RTO/ISO) at the upper level of the "zone of reasonableness" also constitute a multi-billion dollar cost to consumers without any showing by the Commission there is a need for these incentives or any demonstrable concomitant benefit to consumers. If the cost of other proposals contained in the NOPR are also considered (e.g., the incentive accounting changes) the potential costs to consumers are significantly greater than the levels proposed in the NOPPS.

---

[2] Mr. Kahal's Affidavit and supporting documentation ("Kahal Materials") is attached to NASUCA's Comments filed in Docket No. PL03-1-000, *Proposed Policy For Efficient Operation And Expansion of Transmission GrId.* NASUCA requests the Commission take Administrative Notice of the Kahal Materials for the purposes of this proceeding.

The current NOPR seeks to encourage 1) the formation of additional Independent Transmission Companies ("ITOs" or "transcos"); 2) further participation in RTOs by transmission-owning utilities; and 3) enhanced investment in new transmission infrastructure and transmission system operational/technological advancements. While NASUCA supports many of these same goals, the provision of economically efficient transmission service at just and reasonable rates will not be achieved by inflating current transmission rates with the widespread (and maximum) application of the incentive proposals contained in this NOPR.

The Proposed Rulemaking is flawed in many respects. These are the most fundamental flaws:

- The Proposed Rulemaking provides for broad-based (and potentially large) financial incentives that may <u>not</u> be needed.
- The Proposed Rulemaking incentives may be cost-prohibitive.
- The Proposed Rulemaking is contrary to sound economic efficiency principles.
- The Proposed Rulemaking is not in keeping with fair rate of return principles that form the basis of just and reasonable rates.
- The Proposed Rulemaking is inconsistent with the Commission's own principles for incentive ratemaking.
- The Proposed Rulemaking seeks to support the ITC business model which has not yet been demonstrated to be a superior business model for transmission service.

NASUCA urges the Commission to not lose sight of the fact that transmission owners are public utilities which have an affirmative obligation to provide safe, adequate, efficient and reasonable service at just and reasonable rates. Despite the fact that

Congress reiterated these principles in the Energy Policy Act of 2005 and instructs the Commission to review transmission rates, the Proposed Rulemaking fails to comply with the Energy Policy Act's mandate that rates be just and reasonable and potentially enriches all transmission owners at the expense of consumers. NASUCA urges the Commission to adopt clear rules consistent with these comments.

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Promoting Transmission Investment through Pricing Reform	: :	**Docket No. RM06-4-000**

NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES' COMMENTS ON PROPOSED RULEMAKING

I. INTRODUCTION

A. NASUCA

The National Association of State Utility Consumer Advocates ("NASUCA") is a national association of consumer advocate offices with members in 42 states and the District of Columbia. NASUCA's members are charged by their respective state laws with the responsibility to represent consumers in utility proceedings before state and federal regulatory commissions and courts. Many of the NASUCA members have significant experience with the regulation of transmission rates and the implementation of incentive rate programs. This experience informs these comments.

B. Summary of the Proposed Rulemaking

On August 8, 2005, the Energy Policy Act of 2005 ("EPAct 2005" or the "Act") became law. Section 1241 of the Act (Transmission Infrastructure Investment) adds a new section 219 to the Federal Power Act ("FPA") mandating the Commission establish by rule, not later than one year after its enactment, incentive-based (including performance-based) rate treatments that support investment in new transmission infrastructure and improvements of existing infrastructure through technological advancements. The purpose of the EPAct, and therefore these proposed rules, is to benefit consumers by ensuring reliability and reducing the cost of delivered power by reducing transmission congestion. NOPR Summary ¶¶ 1, 2, 3, and 5.

The following comments are submitted in response to the Notice of Proposed Rulemaking ("NOPR") issued on November 18, 2005 by the Federal Energy Regulatory Commission ("FERC" or "Commission").

The Commission's stated purpose in issuing this NOPR mirrors that of the EPAct 2005. It is to increase the reliability of the interstate electric transmission system by encouraging new investment in transmission infrastructure. The legislative mandate and this resulting NOPR ostensibly address the long-term decline in transmission infrastructure investment which occurred during a corresponding period of increasing electric load. The product of these market forces resulted in constrained transmission capacity.

To accomplish the goals of Congress and this NOPR, the Commission has proposed overly-broad and unnecessarily costly incentives to encourage jurisdictional utilities to build new transmission capacity (*Id.* at ¶2) and develop technological advances in new and existing transmission operations (*Id.* at ¶ 3). For all jurisdictional public utilities, including transcos, the cost incentives proposed by the Commission include incentive-based rate proposals, including proposals to:

(1) provide a higher rate of return on equity (ROE) still within a "zone of reasonableness" sufficient to attract new investment in transmission facilities;

(2) provide for the recovery of 100 percent of prudently incurred transmission-related Construction Work in Progress (CWIP) in rate base (as contrasted with the current policy of allowing 50% of

non-pollution control/fuel costs as CWIP and capitalizing the remaining costs [including AFUDC] which would later be included in rate base when the facility is "used and useful");

(3) provide for the recovery of prudently incurred pre-commercial operations costs (for new transmission investment) by expensing these costs instead of capitalizing them;

(4) provide for the utilization of a hypothetical capital structure;

(5) accelerate the recovery of transmission depreciation expense;

(6) provide for the recovery of all prudently-incurred development costs in cases where construction of facilities may subsequently be abandoned as a result of factors beyond the public utility's control;

(7) provide for deferred cost recovery; and,

(8) provide any other incentives approved by the Commission.

NASUCA does not dispute the EPAct of 2005 1) authorizes the Commission to promote capital investment and operational enhancements in the transmission infrastructure; and 2) that this Rulemaking seeks to discharge the Commission's obligations pursuant to the Act and the FPA. However, implicit, if not explicit, in this legislative mandate is the direction to the Commission that it should determine the <u>proposed incentives will create the desired results enumerated in the Acts.</u> Any incentives adopted in this NOPR should correct the circumstances creating the decline in transmission capacity investment during the 1990s. Further, once the Commission identifies the actual circumstances that caused the declining transmission investment, it must then demonstrate the proposed solution produces a cost/benefit to consumers. Incentives that have been determined to meet the nexus and cost/benefits tests - if used at all - should be applied on a narrow, case-specific basis.

As detailed below, NASUCA submits that 1) the broad-based nature of the Commission's NOPR is misguided; 2) such incentives are not required to address transmission capacity constraints; and 3) the Rulemaking, as proposed, will result in a potential cost burden for consumers that will offset the potential benefits that could hope to be achieved. NASUCA maintains that the transmission capacity constraints and inadequate transmission investment experienced in the 1990s did not result from a lack of financial incentives. By providing such incentives now, the Commission will not achieve its stated objectives of efficient transmission expansion and RTO or stand-alone Transco development. Rather, the proposed incentives will result in inefficient system expansion, delay in RTO and ITC formation, and possible delay in transmission expansion. Finally, the proposed incentives will be burdensome and costly to consumers.

II. REGULATORY PRINCIPLES

A. Introduction

The Commission must not lose sight of the fact that interstate electric transmission companies are public utilities which already have an affirmative obligation to serve in an efficient and reasonable manner. FPA, 16 U.S.C. §824; *New York, et. al. v. Federal Energy Regulatory Commission,* 535 U.S. 1 (2002). The development of Commission policies directed toward the creation of reasonable and efficient structures for transmission expansion and planning will serve the public interest. In contrast, the Commission's proposal in this NOPR is unsound and will potentially throw billions of consumer dollars at transmission owners in an untargeted manner with the hope that something will be accomplished – something which is already being accomplished, without such incentives.

The primary goal of the FPA in regulating interstate transmission of electricity is to curb abusive practices by public utilities and to protect customers from excessive rates and charges, such as the ones proposed in this proceeding. *Federal Power Commission v.*

Hope Natural Gas Co., 320 U.S.591, 610, 64 S. Ct. 281,291 (1944) and *Electrical Dist. No. I v. FERC,* 774 F.2d 490, 493 (D.C. Cir. 1985). The Commission has stated that its primary responsibility in administering the FPA is to ensure adequate and reliable supplies of electric energy at a just and reasonable price. *Remedying Undue Discrimination through Open Access Transmission Service and Standard Electricity Market Design,* Docket No. RM01-12-000, "Notice of Proposed Rulemaking" at ¶ 1, 100 FERC ¶61,138 (July 31, 2002). The Commission has an equally important responsibility to ensure that safe, adequate and reliable transmission service can be provided to consumers at a just and reasonable price. 16 U.S.C. §§ 824d, e, and f.

Regulatory principles governing the provision of transmission service at both the state and federal level have developed over many years. The FPA provides that a utility may charge only rates that are just and reasonable. 16 U.S.C. §824d (a). Interpreting this mandate, the Commission and the Courts have found that rates should be based primarily on the cost of providing service to the utility's customers, plus a just and reasonable return on equity. *Alabama Elec. Coop v. FERC,* 684 F.2d 20, 27 (D.C. Cir. 1982); *Sithe Independent Power v. FERC,* 285 F.3d 1, 5 (D.C. Cir.2002); and *Kootenai Electric Cooperative, Inc. v. FERC,* 192 F.3d 144 (D.C. Cir.1999).

For both state commissions and this Commission, in determining the level of rates that satisfy the just and reasonable standard, the Courts require a balancing of investor and consumer interests, as well as protection of consumers from exploitation at the hands of regulated utilities. The general rule when establishing just and reasonable rates is that a public utility, whose facilities and assets have been dedicated to public service, is entitled to no more than a reasonable opportunity to earn a fair rate of return on its investment. This general rule was first set forth in 1923. The standard to evaluate what is a fair rate of return was established by the United States Supreme Court in *Bluefield Waterworks & Improvement Company v. Public Service Commission of West Virginia,* 262 U.S. 679, 693 (1923):

> The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to raise the money necessary for the proper discharge of public duties.

The Supreme Court held in *Bluefield* that the allowed rate of return should reflect:

> [A] return on the value of the [utility's] property which it employs for the convenience of the public equal to that being made at the same time on investments in other business undertakings which are attended by corresponding risks and uncertainties.

262 U.S. at 692.

In short, the allowed return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to raise the money necessary *for the proper discharge of public duties*.

Twenty-one years after *Bluefield* the United States Supreme Court reviewed the issue of fair rate of return in *Federal Power Commission v. Hope Natural Gas Company,* 320 U.S. 591 (1944). *In Hope,* the Supreme Court held that a fair rate of return "should be commensurate with returns on investments in other enterprises having corresponding risks" while being sufficient "to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and attract capital." *Id.* at 603. The Court also noted, however, that "[T]he rate-making process under the Act, i.e., the fixing of 'just and reasonable' rates, involves a balancing of the investor and consumer interests.., and does not insure that the business shall produce revenues." *Id.*

The Supreme Court in 1968 set forth the parameters for the Commission's weighing of competing investor and consumer interests. The Court stated:

> The Commission cannot confine its inquiries either to the computation of costs of service or to conjectures about the prospective responses of the capital market; it is instead obliged at each step of its regulatory process to assess the requirements of the broad public interests entrusted to its protection by Congress.
>
> Accordingly, the 'end result' of the Commission's orders must be measured as much by the success with which they protect those interests as by the effectiveness with which they 'maintain * * *credit and * * * attract capital.'

In Re Permian Basin Area Rate Cases, 390 U.S. 747, 791 (1968). The Court required that this balancing of interests provides "appropriate protection to the relevant public interests, both existing and foreseeable." *Id.* at 792. Quoting from a 1959 Supreme Court decision, the Court stated:

> The consumer is thus obliged to rely upon the Commission to provide 'a complete, permanent and effective bond of protection' from excessive rates and charges.

Id. at 794-795, citing *Atlantic Refining Co. v. Public Service Commission,* 360 U.S. 378, 388 (1959).

Under this line of cases, it has been this Commission's practice over the years to set the fair rate of return for transmission-owning utilities at a "best estimate" of the cost of common equity. The Commission has relied upon market-based methods, such as the discounted cash flow ("DCF") model, for that purpose. The market cost of capital standard is the basis for establishing a transmission owner's authorized return, consistent with the Commission's statutory obligation to set just and reasonable rates. This is a matter of both fairness and economic efficiency.

Although the Commission's objective here is to address transmission capacity constraints, the fact remains that transmission will remain a regulated service for the foreseeable future. The overall rate of return for transmission owners will be used to determine the zonal access charges they will recover from captive customers. Customers have no alternative to paying these charges, and utilities are not at any significant risk in recovering their prudent transmission fixed costs from these customers. Monopoly utilities must be subject to regulation in order to restrain the exercise of monopoly power. NASUCA urges the Commission to apply these legal principles in this NOPR and discard the overly broad incentives it has proposed.

B. The NOPR Is Inconsistent with Proven Principles of Incentive Ratemaking.

1. Introduction

As previously discussed, state and federal laws currently require utilities to provide adequate and reliable transmission service at just and reasonable rates. Section 207 of the FPA requires utilities to provide "proper, adequate and sufficient" transmission services." 16 USC §824f. This Commission has previously rejected the notion that ROE incentives for utility transmission investors are necessary for actions considered to be "best practices" within the industry. *New England Power Pool,* 97 FERC ¶61,093 (2002). Utilities have a public service obligation to maintain adequate and efficient transmission systems. As the debate continues regarding electric restructuring, investment in efficient transmission systems appears to be occurring on its own. No showing has been made that utilities will not continue to pursue economically efficient alternatives consistent with their public service obligation. Indeed, many utilities are already pursuing measures they have determined will bring system efficiencies. For example, under Iowa law, public utilities are required to provide reasonably adequate facilities and service and are required to operate efficiently.[3] Without any special incentives, an Iowa electric utility, MidAmerican Energy Company, has committed to construct 122 miles of 345 KV transmission line in connection with a planned coal generation facility. Currently, there is no incentive ROE associated with this transmission line. *MidAmerican Energy Co.,* Docket No. GCU-02-1, Final Decision and Order at 4 (Iowa Utils. Bd., January 23, 2003);*and MidAmerican Energy Co., IUB* Docket Nos. E-21621, E-21622, E-21623, E-21624 and E-21625 (IUB Order Dec. 8, 2004) (approving franchise petitions).

Moreover, the Commission has previously recognized that for any form of incentive ratemaking, certain principles should be followed to ensure the resulting incentive rates are just and reasonable. These principles have been set forth in a number of cases, Rulemakings, and in Order No. 2000. The Commission's 1992 Rulemaking, Order No. 2000, and its recent Western Order implementing incentive rates provide particular guidance in this area.

NASUCA submits that the Commission's principles for incentive rates are essential to ensuring that incentive rates meet the just and reasonable standard, if incentive rates are to be permitted at all. The NOPR, however, strays from these

[3] Iowa Code Sections 476.8 and 476.52. Both of these statutory mandates require reasonably adequate transmission facilities at reasonable cost, both old and new, without any incentive.

important principles, and cannot be considered an acceptable form of either performance-based ratemaking or incentive ratemaking.

2. The Commission Has Failed to Follow the Principles of Incentive Ratemaking in Its 1992 Rulemaking or Order 2000.

The Commission issued a Rulemaking in 1992 outlining the appropriate use of incentives. *Re Incentive Rate Making for Interstate Natural Gas Pipelines, Oil Pipelines, and Electric Utilities,* 61 F.E.R.C. 61,168 (1992) ("1992 Rulemaking"). In the 1992 Rulemaking, the Commission affirmed four standards and issued a fifth standard designed to assure that incentive ratemaking is fair. The five standards are: a) incentive mechanisms must be prospective; b) participation must be voluntary; c) incentive mechanisms must be understood by all parties; d) benefits to consumers must be quantifiable; and e) quality of service must be maintained. *Id.* at 61,589-61,590.

In Order No. 2000, the Commission approved the use of incentive rate mechanisms under conditions that are consistent with these standards. *Regional Transmission Organizations, Order No. 2000,* FERC Stats and Regs. [Regulations Preambles July 1996 - December 2000] ¶31,089 (1999), *Order on Reh'*g., Order 2000-A, FERC Stats and Regs [Regulation Preambles July 1996 - December 2000] ¶31,092 (2000), *petitions for review dismissed, Public Utility District No. I of Snohomish County, Washington v. FERC,* 272 F.3rd 607 (D.C. Cir. 2001) (Order No. 2000). Order No**.** 2000 explicitly discusses new approaches to return on equity as part of incentive ratemaking. The Commission therefore invited RTOs "to submit proposals for ROE-programs" but did not require such a program. Order No. 2000 at 31,193. The Commission reaffirmed that the pricing and return setting goal is**:**

> to ensure that customers have access to non-discriminatory service at just and reasonable rates, and that transmission owners have an opportunity to earn a reasonable rate of return on their investment.

Id. Although Order No. 2000 provides considerable latitude for the filing of incentive rate proposals, the Commission established certain standards or requirements necessary to support these proposals similar to those previously detailed in the Commission's 1992 Rulemaking.

Specifically, the Commission stated that applications for innovative rate treatments "must explain how the proposed rate treatment would help achieve the goals of RTOs, including efficient use of and investment in the transmission system and reliability benefits to consumers; provide a cost-benefit analysis, including rate impacts; and explain why the proposed rate treatment is appropriate for the RTO proposed by the Applicant." Order No. 2000 at 31,171. Order No. 2000 also required that the proponent of the incentive ratemaking demonstrate that the proposal is appropriate, just, reasonable and nondiscriminatory. *Id.*

The pending NOPR is inconsistent with the standards of the 1992 Rulemaking and Order No. 2000. The NOPR simply sets aside the important principles established by these orders. Two key standards from the Rulemaking and Order No. 2000 that form the heart of the consumer protection provisions have not been followed by the Commission here. First, the NOPR provides no cost/benefit assessment (and further specifies that none is needed), nor does it require any estimate of rate impacts or demonstration that the proposal will provide just and reasonable rates (although the Commission acknowledges rates set must be just and reasonable). Second, the NOPR provides rewards for past actions and requires no demonstration that actions would have been taken but for the incentive.

3. The NOPR Is also Inconsistent with Performance-based Rate Proposals in Order No. 2000.

Order No. 2000 also discussed principles for performance-based ratemaking (PBR). The NOPR also fails to satisfy these principles for several reasons. Most importantly, the Commission's NOPR is asymmetric.

This Commission sanctioned and invited incentive rate and PBR proposals as part of its Order No. 2000. In doing so, the Commission established the following standards:

(1) PBR should not be piecemeal.

(2) PBR should encompass both rewards and penalties.

(3) PBR should foster efficiency and not impair reliability.

(4) The benefits flowing from PBR should be shared with the RTO and customers.

(5) The PBR system of rewards and penalties should be based on known and measurable benchmarks.

Order No. 2000, at 31,185.

By the Commission's own rationale, any reasonable plan which seeks to address performance or provide incentives must include both penalties and rewards, not just rewards. As an example, price cap plans establish formulas for rate increases or decreases that are linked to cost control and productivity gains. A plan that allows for excess profits when a performance benchmark is exceeded, but does not reduce utility profits when performance falls short of the benchmark, would be unreasonable and would fail to balance customer and utility investor interests. The Commission's proposal provides incentives that work only in one direction - to increase utility profits - with no performance accountability. This is one-sided and inherently unfair.

4. The NOPR Rewards Past Actions Contrary to the Principles of Incentive Ratemaking.

As a careful reading of the EEI Study shows, jurisdictional transmission companies have already increased investment in transmission facilities or plan significant investment in transmission facilities over the next several years. The Commission has previously stated that "Incentive regulation is not designed to reward past efficient, cost-saving behavior. To do so would violate the objective of benefiting customers." *1992 Rulemaking at 61,589.* This principle recognized that incentive rates should benefit consumers by requiring that benchmarks or performance exceed existing levels. An incentive proposal that rewards an entity for past acts violates this most basic tenet of incentive ratemaking: that an entity seeking an incentive must actually *do* something beyond existing, or reasonably expected, performance.

The current pricing proposal fails to meet this basic principle in several ways. First, it allows utilities that have already embarked upon transmission investment programs to receive an incentive. Transmission owners who have taken this step have done so either to pursue their own interests or may have been required to do so by statutory or regulatory directive. Second, for utilities that have not yet embarked upon new transmission investment or technological advancements, there is no requirement for a showing that, but for the incentive, the utility would not otherwise have taken these actions. Without these two key components, the necessary protections for consumers to ensure that incentive rates are just and reasonable do not exist. The NOPR, which violates this basic principle, cannot result in just and reasonable rates.

5. The Commission's NOPR Deviates from the Western Order re: ROE Adders.

The Commission recently approved a series of narrow, focused equity return incentives for the construction of new or upgraded transmission capacity in California and Western markets in order to spur development of needed infrastructure to remedy the specific crisis faced by those markets during 2000-2001. *Removing Obstacles to Increased Electric Generation and Natural Gas Supply in the Western United States.* 96 F.E.R.C. 61,155 (2001) (*"Western Order"*). Under the Commission's first adopted incentive, a 200 basis point ROE adder was given on upgrades at existing constrained facilities if those upgrades were in service by July 1, 2001, and 150 basis points if in service by November 1, 2001. *Id.* at 61,669. The second incentive allowed a 100 basis point premium for new facilities not already in use that would add significant transfer capability and could be in service by November 1, 2002. *Id.* The third incentive allowed a 150 basis point return on equity adder for facilities needed to interconnect new supply to the grid put into service by November 1, 2001, and 100 basis points if in service by November 1, 2002. *Id.*

The *Western Order* differs from the current incentive pricing proposal in two important respects. First, there was evidence to support the assumption that the costs to consumers due to incentives would be outweighed by the benefits they would receive from increased transmission infrastructure. Second, the return on equity adders allowed in that case served as an incentive for new development that addressed a specific need of consumers. Regarding these two principles, the *Western Order* was entirely consistent with incentive ratemaking principles as espoused by the Commission in its 1992 Rulemaking and Order No. 2000.

In the *Western Order*, the Commission allowed the incentives while stating:

> (W)e fully considered the impact on ratepayers... We also considered that the potential savings on the commodity side due to greater transmission capacity and less congestion far outweigh the costs embodied in these incentives, and will not unduly burden ratepayers..."

Id. at 61,671. The investment being incented in the *Western Order* was specific and necessary to relieve constraints, improve transfer capability, or attract new supply. The Commission also stated:

> We noted that we adopted these incentives due to the extraordinary circumstances surrounding the ongoing imbalances in California's electricity power supply system, as reflected by the severity of the power shortages in the WSCC in general and in California, specifically. Due to the need for immediate relief, the May 16 Order departed from the Commission's normal process for determining the case-by-case return on equity allowances.

Id. at 61,670. The incentives were then linked to specific activities that addressed market conditions in order to benefit consumers. In the *Western Order*, the Commission stated that due to tight generation and transmission resources in the Western markets, "the higher prices that inevitably result from the limited supply affects ratepayers more than the minor effects of the rate incentives." *Id.* at 61,671. As demonstrated below, however, there is no way to conclude that benefits, if any, derived from the incentives proposed in the Commission's NOPR will outweigh the costs.

The *Western Order* also recognized that an important feature of incentives is that they must actually foster development and investment that would, but for the incentive, not occur. The Commission limited the return on equity adder to facilities that were placed in service by specific dates in order to relieve the California energy market crisis as quickly as possible. Thus, the allowed incentives provided a reason to increase efforts to bring projects on line. Furthermore, the Commission applied these targeted equity incentives narrowly to embedded costs or to construction projects that were near completion and undertaken without any knowledge of the ordered incentive. As the Commission stated, "With respect to Cities/--S-R's concern that this option should not be available to projects that are near completion, current projects will be eligible for the incentives if they show that the construction schedule was accelerated in response to the incentive program, and the facilities are placed into service within the prescribed time frames." *Id.* at 61,671.

The Commission's prior principles have established the basis for the consideration of whether incentive rate proposals or performance-based ratemaking proposals can result in just and reasonable rates. Here, the Commission's NOPR deviates so significantly from the Commission's own fundamental principles, that it cannot be considered to result in just and reasonable rates.

The Commission's desire to ensure reliable interstate transmission should not unseat long-standing regulatory principles that govern monopoly transmission service or the delicate balance espoused in those principles between shareholder and consumer interests. Tipping the balance in favor of shareholders at the expense of consumers merely sanctions the exploitation the FPA seeks to avoid, and ultimately will cause harm to consumers that is not outweighed by any benefits of wholesale competition. The Commission's NOPR cannot be considered to meet any of the principles of incentive-based or performance-based ratemaking.

6. Conclusion.

The Commission, having satisfied its mandate pursuant to the EPAct 2005 and the FPA, should make a determination that the broad-based application of performance-based ratemaking, incentive-based ratemaking and the various accounting treatments proposed that are extremely favorable to utility shareholders are not necessary to address the severe downturn in transmission capacity investment during the 1990's. To support this determination, the Commission need look no further than the very document it cited to support the need for such incentives: the EEI survey. The cause of transmission investment decline during this period was not the lack of incentives. It was the uncertainty of deregulation. Since 1999, transmission investment increased significantly, and planned projects through 2006 are about $6 billion – well in excess of the $5 billion the Commission is targeting. For these reasons alone, broad-based incentives should not be further pursued.

The NOPR potentially provides very substantial and costly rate of return adders to transmission-owning utilities based upon actions already taken or planned. While the Commission argues that these actions will be beneficial, this is not a defensible form of performance or incentive-based regulation that warrants a departure from cost-based ratemaking.

Even if the incentives proposed were to create increased transmission capacity, the rate of return adders proposed under this Rulemaking do not have performance benchmarks previously and correctly required by the Commission. The transmission owner should be required to achieve some specified level of performance. Instead, the adders and incentives simply reward shareholders – at the expense of consumers - for doing little more than what they are already undertaking or required by law to undertake. The utility need not provide any demonstration of customer savings, efficiency gains, improved service quality or any other performance measure. The utility is not even required to submit a cost/benefit filing showing that any performance gains are likely. The utility will receive its rate of return bonuses automatically even if its performance in providing service deteriorates.

The Commission must adhere to the incentive ratemaking principles it laid out in its 1992 Rulemaking, Order No. 2000, and applied in the *Western Order*, described above in order to achieve fairness in rates. As the Commission stated:

> Incentive ratemaking *must be* fair. Properly done, all can benefit; improperly done, it may hurt parties - especially those the Commission has historically protected - as much as it helps. Incentive ratemaking must simultaneously protect customers' interests and offer potential rewards to the utility for good performance.

The Commission must evaluate its current proposal with these principles in mind. As is quickly seen, the proposal completely fails to meet these principles. As such, this proposal should be reconsidered. Instead, the Commission should adopt a more narrow and focused approach in addressing the legislative mandate of the EPAct 2005.

III. LEGAL, TECHNICAL AND POLICY FLAWS IN THE COMMISSION'S PROPOSAL

A. Introduction

NASUCA recognizes the underlying goal of the Commission is to encourage needed transmission expansion. The NOPR, however, will not contribute to achieving the Commission's goals. In fact, the Commission's proposal will interfere with the

Commission's own objectives as well as the progress that has been made to date. NASUCA submits that throwing consumer money at the "problem" in such an untargeted manner (which fails to address the source of the problem in the first place) will only succeed in harming consumers and impairing economic efficiency. The Commission's proposal did not address the cause of constrained transmission capacity and will be a step backward not a step forward.

NASUCA discusses below several of the major legal, technical and policy flaws in the Commission's approach.

B. Incentives for Investment in Transmission Infrastructure Not Necessary.

The Commission cites estimates in the EEI Study that capital spending (on transmission) must annually increase by 25% (i.e., or $1 billion per year – from $4 billion to $5 billion) to assure system reliability and to accommodate the growth of wholesale electric markets (NOPR, p.2). The Commission fails to acknowledge that a careful reading of the EEI Study reveals that there have already been substantial increases in transmission investment. Transmission investment grew 12% annually from 1999 to 2003 (EEI Survey, p.3). The Commission also cites the EEI Study for its conclusion that transmission investment must increase to $5 billion annually by 2008.

However, the same EEI Study shows that Transmission Owners ("TOs") are planning to increase such investment in the future even <u>without</u> the financial incentives being discussed in this NOPR. In fact, forecasted annual levels of such expenditures will reach levels not seen in nearly 30 years (EEI Survey, p.5). The planned increase cited for the period 2004 through 2008 would represent a 60% increase over the period 1999 through 2003 (EEI Survey, p.5). EEI extrapolates annual expenditures of approximately

$6 billion by 2006 for the investor-owned sector (i.e., $1 billion more than the Commissions' goal in promulgating this incentive rulemaking) (EEI Survey, p.6). In short, planned expenditures will exceed the level cited by the Commission as the basis for the remedies offered in the NOPR.

In addition, those regions served by an RTO or ISO appear to be making the transmission investments dictated by their respective planning process. Transmission projects for reliability purposes seem to be built in a timely manner as they are identified as part of the RTO/ISO planning process. PJM, for example, recently reported that an additional $464 million in transmission upgrades has been approved. Total investments approved (since 2000) are approximately $2 billion. All of these projects were identified through the PJM planning process. All of these projects would be built without the incentives proposed in the NOPR. Similarly, now that the Midwest ISO's LMP-based market is now functioning, the Midwest ISO is now turning increasing attention to planning relating to transmission issues.

Such important initiatives within the RTOs conflict with the Commission's statement that the "…need for capital investment in energy infrastructure" may be a "…national problem that requires a national solution." (NOPR, p.3). In short, the issue may be more localized and prevalent in areas not covered by RTOs/ISOs. NASUCA respectfully requests the Commission more specifically identify where (and by how much) transmission investment for reliability purposes is falling short of planning needs. The adoption of any specific approach (or approaches) to rectifying a still undefined (and perhaps nonexistent) problem is not an acceptable form of rulemaking – or ratemaking.

C. Proposed Incentives Are Cost-prohibitive.

The proposed incentives contained in the current NOPR could result in costs to consumers that offset any benefits from the development of wholesale competition through the employment of the RTO/ISO framework. In Docket No. PL03-1-000, FERC's Notice of Proposed Policy Statement ("NOPPS") envisioned automatic Return on Equity ("ROE") incentive adders for certain actions taken by transmission owners. The specific adders included: 1) 50 basis points for any entity that transferred operational control of its transmission facilities to a FERC-approved RTO/ISO; 2) 150 basis points for any independent ITC that participated in a FERC-approved RTO/ISO; and, 3) 100 basis points for investment in new transmission facilities (i.e. built pursuant to an RTO planning process) (NOPPS, p.2). Under this proposal, the incentives were potentially additive resulting in possible total incentives for existing transmission of up to 200 basis points and total incentives for new transmission investment of up to 300 basis points.

NASUCA strenuously opposed the equity incentive proposals contained in the NOPPS (NASUCA Comments, p.2). NASUCA's opposition was supported by the Kahal Materials. The Kahal Materials conservatively estimate the proposed incentives contained in the NOPPS (if fully utilized by transmission owners) would cost consumers over $13 billion for the 19-year timeframe (i.e., $711 million per year). This cost was subsequently compared to FERC's own study (i.e., conducted by ICF Consultants) of the potential benefits of RTO formation. FERC's study estimated approximately $725 million per year in efficiencies. Thus, the cost of the proposed incentives virtually offset the potential benefits of RTO formation. Moreover, the incentives served little purpose since a large number of transmission owners already participated in RTOs/ISOs (NASUCA Comments, p. 2).

The total costs of the current NOPR may be prohibitive as well. First, the NOPR fails to place a limit on the total incentives available for any single transmission owner. Thus, a given transmission owner may apply for one or more (and potentially all) the incentive options. In addition, the incentive available under any particular option is not limited. Given that the NOPR specifies a broad number of potential options beyond just the incentive available for joining a RTO/ISO, the total costs of the entire incentive "package" for all transmission owners could even exceed the Kahal Materials cost estimate for the incentives contained in the NOPPS. In addition, overall RTO/ISO costs have increased significantly over the past few years. NASUCA believes that consumers should benefit from broader wholesale competition. Dramatically increasing the costs of achieving such competition does not seem to be a route the Commission should pursue.

Furthermore, significantly higher costs could delay RTO/ISO formation in certain states. State commissions usually exercise approval authority over efforts to join an RTO/ISO or to divest transmission to an ITC. Many states also exercise certification or siting authority for major new transmission projects. The potential cost impact on consumers of the incentives contained in the NOPR could reduce the likelihood of state approvals for participation in RTOs/ISOs and/or ITCs (i.e., it would be more difficult for the transmission owner to demonstrate that transmission divestiture or RTO participation is in the "public interest" of that state). Certification and siting for transmission projects could potentially be negatively impacted as well.

The proposed incentives could also slow the adoption of retail choice. In states that have not unbundled rates, the retail charge for transmission service is determined by the state regulator. Such states may attempt to spare retail customers the burden of the NOPR's incentives.

D. The Proposed Incentives Do <u>Not</u> Promote Economic Efficiency or Produce "Just and Reasonable" Rates.

As noted in the Regulatory Principles section of these comments, a public utility is entitled to no more than a reasonable opportunity to earn a fair rate of return on its investment. Over the years, this Commission has set the overall fair rate of return for transmission-owning utilities by developing a "best estimate" of the entity's cost of common equity. The Commission has relied upon market-based methods (e.g., the DCF method). The use of a market-based cost of equity as the basis for establishing a transmission owner's authorized return is consistent with the Commission's obligation to set "just and reasonable" rates. This is a matter of both fairness and economic efficiency.

The NOPR's proposed incentives will increase the overall transmission rates recovered from captive ratepayers. Customers have no alternative to paying these charges and transmission-owning utilities face little significant risk for recovery of their prudent costs from these same customers. Systematically and intentionally setting a utility's overall authorized return above its actual cost of equity (and therefore setting the utility's return above its actual cost of service) is a form of monopoly pricing. This unwarranted transfer of wealth from customers to transmission owners is inherently unfair and inconsistent with the regulatory principles discussed herein. In short, the employment of broad-based, and relatively large, incentives that significantly increase the overall rate of return available to transmission owners cannot result in rates that are "just and reasonable."

In addition, such incentives cannot be justified on the basis of added risk to the transmission owners. The NOPR does not assert that joining a RTO/ISO; divesting transmission assets to an ITC; or, investing in any particular transmission project will generally and systematically increase a transmission owner's risk profile. Even if such an increase in risk would occur, the market-based cost of capital would increase accordingly.

Furthermore, economic efficiency is not promoted through artificially inflating a utility's overall authorized rate of return above its market cost of capital. Excessive overall returns may provide incentives to inflate transmission rate base and distort the relative mix of inputs to provide service. Even an RTO/ISO planning process will not eliminate the potential incentive to inflate the costs of approved transmission projects. As a result, the added costs to consumers reflect the higher project costs, as well as the effects of higher overall returns.

Several of the proposed incentives (e.g., enhanced ROE or joining an RTO/ISO) involve setting the utility's return at the upper end of a "zone of reasonableness" (established supposedly through the DCF method). In short, the fair rate of return will no longer be set at the Commission's best estimate of the cost of equity but at an artificially higher figure. The upper end of the "zone" may be reasonable for the high-risk companies (in the particular "proxy" group being employed) but certainly is not representative for low-risk companies. Such a practice will face several practical problems as well. The selection of a proxy group becomes even more important in such a process. Unfortunately, certain proxy groups will not have a meaningful number of companies. Transcos are an example of this problem. Another example is determining the appropriate proxy group for a utility in a fully bundled state that utilizes an Independent Transmission Coordinator. Future litigation will focus on the selection (and limitations) of the appropriate proxy group, as well as, debate over the "top end" of the "zone." As a result, settlements on equity issues may become harder to achieve.

NASUCA submits that the Commission's NOPR is contrary to the sound regulatory principles the Commission has followed for decades in establishing rates that are just and reasonable. Additionally, the proposed cap on the ROE adder at the high end of a "zone of reasonableness" does not and cannot solve the perceived transmission capacity problems. It is a misguided policy and simply creates additional problems.

E. There Is No Evidence that ITCs Are a Superior Business Model.

As noted in the Summary of Proposed Rulemaking, *supra,* the Commission appears to favor the ITC business model. However, the only "evidence" provided to support the Commission's faith in that business model was the historical and forecasted investment figures for two ITCs. On one hand, forecasted investment may or may not actually occur. On the other hand, should the forecasted investment actually occur, it would occur without any of the NOPR's incentives.

In addition, no evidence has been provided that the ITC is the most appropriate business model for transmission on an industry-wide basis. For example, no claim was made (or supported) that the transmission service provided by an ITC is superior to the transmission service provided by utilities that operate within an RTO/ISO structure. Given the lack of evidence to support the NOPR's assertions relating to the ITC model, NASUCA believes that a definitive conclusion cannot presently be reached that an ITC is the superior business model for transmission service in all cases or that significant incentives must be provided to promote further asset divestiture to ITCs.

The Court has made clear that protection of consumer interests from excessive rates and exploitation at the hands of monopolies *must be given as great a weighting by the Commission as the interests of the utilities themselves.* NASUCA submits that this NOPR inappropriately distorts this fundamental and important balance.

NASUCA would also note that it has long been understood by economists that artificially inflating a utility's authorized rate of return above its market cost of capital is inconsistent with economic efficiency principles. An excessive authorized rate of return will provide incentives to inflate rate base, and will distort the mix of inputs to provide service.[4] While an RTO-supervised planning process, or accelerated rate treatment of transmission capacity-related expenses will be helpful in mitigating such distortions, it will not eliminate the problem of distortions in the planning process resulting from such incentives. An RTO planning process will also not eliminate the transmission owner's incentive to inflate or "gold plate" the costs of approved projects. As such, the added costs to consumers is not merely the effects of higher rates of return, but also the potentially inflated costs of unnecessary or gold-plated transmission projects that could result from this process.

F. FERC's Implementation Proposal Is Vague and Appears to Contemplate Impermissible Single-issue Ratemaking.

The NOPR contains a very few, brief statements related to process issues. The Commission proposes that eligible public utilities would make a Section 205 filing to

---

[4] The seminal article on this issue is Averch, H. and Johnson, L. 1962. "Behavior of the Firm Under Regulatory Constraint," American Economic Review. 52, 1052-69.

receive authorization to obtain the proposed incentives. The Commission further states that it would not require a cost-benefit analysis as part of that Section 205 case. *Id.* The Commission then states that a cap will be imposed equal to the top of the range of reasonable ROEs using a hypothetical capital structure. No other information is provided as to process. The NOPR does not give clear indications regarding process, which makes it difficult to evaluate what it is the Commission is proposing and what the potential issues are. While NASUCA cannot anticipate all possible issues, NASUCA will comment regarding its concerns about the single-issue ratemaking process.

The Commission proposes to allow eligible utilities to avail themselves of the incentives proposed in the Rulemaking through the filing of Section 205 rate proceedings. Three possible courses of action include: a) a traditional Section 205 rate case with full review of all cost and revenue elements in the rate ease; b) a limited proceeding leading to certification that the utility is eligible for the incentives, but leaving the actual increase in rates to the utility's next full Section 205 rate case; or c) a limited Section 205 rate filing in which only the issue of the rate of return and the incentive adder is considered. In the event that the Commission is considering a limited form of filing, NASUCA urges that the Commission reject such an approach.

Section 205 of the Federal Power Act allows electric utilities to file for increased rates. 16 U.S.C. § 824d. This statute authorizes the Commission to suspend the effectiveness of the proposed increase for a five month period, and further provides that the rate increase may go into effect subject to refund after full investigation and hearing as to the justness and reasonableness of the proposed level of rates. *Id.* The Courts have generally construed this provision to require investigation into the entire range of a utility's costs that underlie the proposed increase. *Cities of Batavia, et al. v. FERC,* 672 F.2d 64 (D.C. Cir. 1982); see *also Colorado Interstate Gas Company v. FERC,* 791 F.2d 803,807 (10th Cir. 1986).

In *Cities of Batavia,* the Court determined that the Commission has authority in Section 205 rate cases to review ". . . a revised rate completely to assure its parts - old and new - operate in tandem to insure a 'just and reasonable' result. . . ." *Id.* at 77. The Court also determined that where a party challenging a utility's rates demonstrates that increased revenues will result in the near future, it would he arbitrary and capricious to adopt a presumption that costs will rise to offset the increased revenues. *Id.* at 75. Thus the Court imposes on the utility the burden of proving both cost and revenue elements in a Section 205 rate case. *Id.*

The Courts have applied similar reasoning in deciding interstate pipeline cases under the Natural Gas Act, whose Section 4 rate requirements track the provisions in Section 205 of the Federal Power Act. In *Colorado Interstate Gas Co.,* the Court found that:

> By filing a rate increase, a... company assumes the risk of having to justify its entire rate structure, including integral provisions of that structure which the company does not propose to change.

Colorado Interstate Gas Company v. FERC, 791 F.2d 803,807 (10th Cir. 1986, citations omitted).[5]

---

[5] The ratemaking provisions of Section 205 of the Federal Power Act, 16 U.S.C. §824d, and Section 4 of the Natural Gas Act, 15 U.S.C. §717c, contain very similar language relating to Commission authority to regulate the justness and reasonableness of electric utility and interstate natural gas pipeline rates respectively. The precedents under those statutes have been followed interchangeably by the Courts without distinction between natural gas and electricity cases. *FPC v. Sierra Pacific Power Co.,* 350 U.S. 348, 353 (1956).

In a 1999 decision in a Northern Border Pipeline Company docket, the Commission applied this fundamental principle, stating that:

> The Commission has held that these provisions of section 4 govern any pipeline proposal to increase its rates based upon a proposed increase in its overall cost of service. That includes both the individual cost of service components the pipeline proposed to increase and those that it left unchanged. As the Commission explained in Tennessee and Northwest, each component of the pipeline's cost of service is an integral part of the pipeline's proposed overall rate increase. Therefore, the pipeline's burden under NGA section 4 of "showing that an increased rate or charge is just and reasonable" necessarily includes the burden of supporting each component of the cost of service, the unchanged as well as the changed components. Moreover, to the extent the pipeline fails to sustain that burden, the Commission may order refunds of the overall increase in the cost of service. This result is consistent with the fact that section 4 speaks solely of 'increased rates or charges,' without distinguishing between the cost components that make up those rates and charges.

Northern Border Pipeline Company, 89 FERC ¶61,185 at 61,575 (1999) (footnote citation omitted). Essentially, the federal courts and the Commission recognize that as one item of cost in a public utility's cost of service increases, it is possible that offsetting cost decreases may have occurred. *Arkansas Power & Light Co. v. Missouri Public Service Commission,* 829 F.2d 1444, 1451-52 (1987). The establishment of just and reasonable rates for consumers would require analysis of not only those items of a utility's cost of service, such as return on equity, that have allegedly increased, but would also require consideration of those items of cost of service that have decreased. *Id.* Only by considering both sides of the issue can the Commission fulfill its statutory mandates in Section 205 of the FPA and Section 4 of the NGA to protect consumers from the utility's ability to extract monopoly rents and from unjust and unreasonable rates. Consequently, the Courts generally require the Commission to review all elements of cost of service in FPA Section 205 and NGA Section 4 proceedings initiated by the utility.[6]

Most utilities that are likely to avail themselves of the incentives proposed in the NOPR are utilities whose rates were set some time ago. Some of those utilities have transmission rates for native load that were approved by state regulatory commissions and transmission rates for wholesale transactions that were approved by this Commission. At the time the utilities made the Order Nos. 888 and 2000 compliance filings, the Commission allowed the utilities to establish rates based on the same overall level of revenues authorized in the utility's last state or federal rate case. Order No. 888 was issued in 1996 and Order No. 2000 was issued in 1999. This means that the last rate case for most of those utilities occurred some time ago. Consequently, many of those rates were established when the level of transactions, particularly in wholesale markets, may have been lower than today. Even the Commission in Order No. 2000 recognized that increased use of the transmission grid nationwide has resulted from the development of more competitive wholesale markets under Order Nos. 888 and 2000. *Order No. 2000* at 30,996 - 30,997. As a result it is possible that many electric utilities today are over-earning their currently authorized returns. Providing increases of up to 300 basis points on already excessive ROEs would only further exacerbate any current problem.

The primary responsibility of the Commission under the FPA is to protect consumers from exploitation at the hands of regulated utilities. *Federal Power*

---

[6] Waivers of the general rule for full blown rate cases are found only in limited circumstances, for example where the utility is merely an accounting conduit for rate changes made by another utility from which the first utility purchases services. *Panhandle Eastern Pipe Line Co. v. FERC,* 613 F.2d 1120 at 1127 (D.C. Cir. 1979).

Commission v. Hope Natural Gas Co., 320 U.S. at 610, 64 S.Ct. *at 291; Accord, Phillips Petroleum Co. v. State of Wisconsin,* 347 U.S. 672 at 685, 74 S.Ct. 794 at 800-801 (1954) and *Electric Dist. No. I v. FERC,* 774 F.2d 490, 493 (D.C. Cir. 1985). While NASUCA disagrees that the broad-based incentives proposed in this NOPR constitute a reasonable approach to providing incentives to utilities, if the Commission nonetheless decides to pursue this approach, any Section 205 filing to implement such incentives must be fully investigated to assure that the overall level of revenues authorized, even with the incentive adders, remains just and reasonable. The Commission can only accomplish that goal by ensuring full review of all of the utility's cost and revenue components. Providing a 50 to 300 basis point adder to equity returns through a single-issue rate case where current rates may already result in excessive returns merely requires consumers to pay even higher rates which are unjust and unreasonable.

IV. CONCLUSION

NASUCA strenuously opposes the Commission's incentive proposal. The proposal is contrary to the fundamental principles of just and reasonable rates – which the Energy Policy Act explicitly requires to apply to any transmission incentive rates – and will likely result in costs to consumers that offset benefits the Commission believes will enhance transmission investment or from RTO development. More to the point, however, these incentive dollars serve no useful purpose nor provide any additional benefit because many jurisdictional transmission owners have already embarked upon transmission infrastructure investment, operational enhancements to transmission facilities, already participate in RTOs or organizations presently seeking Commission

RTO approval, as discussed in the EEI Survey. Even assuming, *arguendo,* that performance-based ratemaking or incentive-based ratemaking is necessary to encourage transmission infrastructure development (which NASUCA disputes), the ROE adders and accounting treatments constitute a high cost to consumers without the required concomitant benefits.

The NOPR seems to serve no purpose but to enrich transmission owners and make the supply of electricity more costly for consumers. NASUCA opposes the NOPR, which is a multi-billion dollar giveaway of consumer money. For those states that have supported many of the Commission's RTO policies, this proposal would provide transmission owning utilities with "incentives" for things they have already done. Indeed, in some cases, such as RTO participation, the action has been mandated by state law or as merger conditions by this Commission. The Commission should not pay retroactive incentives to transmission owners to obey this Commission's Orders or comply with state laws. As for states where consumer advocates and state commissions have argued forcefully that this Commission's policies will harm consumers, giving utilities higher overall returns does not make these policies better for consumers; it just makes them much more expensive. The same logic applies with respect to transmission infrastructure improvements. The Commission should not spend consumers' money to encourage development that is already taking place without any incentives.

NASUCA urges the Commission to incorporate these comments when adopting clear rules in this proceeding.

Respectfully submitted,

NATIONAL ASSOCIATION of STATE
UTILITY CONSUMER ADVOCATES

Janine L. Migden-Ostrander
Ohio Consumers' Counsel

By: /s/ Jacqueline Lake Roberts
Jeffrey L. Small
Jacqueline Lake Roberts
Assistant Consumers' Counsel

Randell J. Corbin
Senior Energy Policy Advisor

Office of the Ohio Consumers' Counsel
10 West Broad Street, Suite 1800
Columbus, Ohio 43215-3485
Phone: (614) 466-8574
Fax: (614) 466-9475
roberts@occ.state.oh.us

NASUCA
8380 Colesville Road, Suite 101
Silver Spring, MD 20910
Phone: (301) 589-6313
Fax: (301) 589-6380

CERTIFICATE OF SERVICE

I hereby certify that I have served the foregoing document upon the Parties of Service listed below, via Regular U.S. Mail Service, postage prepaid, and/or via Electronic Mail Transmission this 11th day of January, 2006.

/s/ Jacqueline Lake Roberts_____
Jacqueline Lake Roberts
Assistant Consumers' Counsel

PARTIES OF SERVICE

Perry J. Cole
Managing Director
Energy Capital Partners
3420 North Hillcrest Dr.
Butte, MT 59701

Patricia F. Godley
Van Ness Feldman, PC
1050 Thomas Jefferson St., NW Fl. 7
Washington DC 20007-3837

Sandra L. Hall
Assistant General Counsel
Maryland Public Service Commission
Public Service Commission
6 Saint Paul St., Fl. 16
Baltimore, MD 21202-6806

Denise K. Parrish
Wyoming Office of Consumer Advocate
2515 Warren Ave., Ste. 304
Cheyenne, WY 82002

John H. Resing, President
Semantic Applications, Inc.
10307 NE 19th Place
Bellevue, WA 98004

Bruce J. Freeman, Administrator
Wyoming Office of Consumer Advocate
2515 Warren Ave., Ste. 304
Cheyenne, WY 82002

Fay A. Chu
Deputy City Attorney
Lost Angeles Dept. of Water & Power
111 N. Hope St., Rm. 340
Los Angeles, CA 90012

Jeff Taylor
Assistant Attorney General
New Mexico Office of Attorney General
407 Galisteo St.
Santa Fe, NM 87501

Markham A. Quehrn, Esq.
Perkins Coie LLP
Suite 1800
411 108th Ave. NE
Bellevue, WA 98004

David Drexler
Assistant Counsel
Public Service Commission of New York
Three Empire State Plaza
Albany, New York 12223-1350

Enrique Martinez, COO
Los Angeles Dept. Water & Power
111 North Hope St., Rm. 921
Los Angeles, CA 90012-5701