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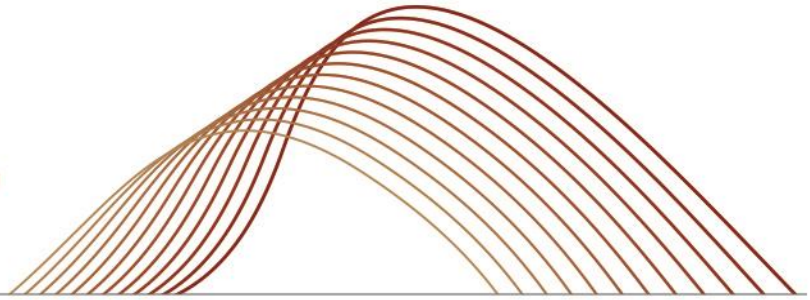

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Comment Deadline Approaches for FERC's Proposed Transmission Incentives Rule

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The Federal Energy Regulatory Commission ("Commission" or "FERC") recently issued a Notice of Proposed Rulemaking ("NOPR") proposing to revise its existing transmission incentives policy and corresponding regulations.[1] The Commission's intent in proposing these revisions is to adapt its transmission incentives policy to the constantly evolving landscape of transmission infrastructure planning, development, operation, and maintenance. FERC asserts that the drivers of the reforms include the diversification of the resource mix, abundance of new resources requiring transmission, shifting load patterns, increased transmission planning spurred by recent Commission rulemakings, and emerging challenges to maintaining structural reliability.

Since the release of the NOPR, the positions of various industry participants discussed in comments in energy media outlets have aligned along anticipated sides. Transmission owners and developers in some cases do not believe that the Commission has gone far enough in increasing access to incentives, or has proposed to place new burdens on, or even taken away, incentives they have been counting on. Transmission customers, on the other hand, fear the proposed reforms are too generous to transmission owners, and are concerned by the potential of higher transmission costs. Comments are due to be filed with the Commission by **July 1, 2020**, and the significant level of informal comments and discussion thus far will help parties focus their comments on the various proposals included in the FERC NOPR.

I. Highlights of the Transmission Incentives NOPR

The NOPR proposes substantial revisions to the Commission's transmission incentives policies. Specifically, FERC proposes to:

- Discard the "risks and challenges" approach that FERC has utilized based on previous rulemakings, in favor of a benefits assessment for return on equity ("ROE") incentives, with a particular focus on the benefits of reducing costs and ensuring reliability.
- Offer ROE incentives for projects that demonstrate exceptional economic benefits compared to other transmission projects, based on *ex ante* and *ex post* benefits-to-costs analyses.
- Offer an ROE incentive for projects that demonstrate significant reliability benefits.

- Modify the Abandoned Plant Incentive to commence from the date the project is selected in a regional transmission planning process for cost allocation purposes, rather than the date the Commission grants the incentive.
- Eliminate the ROE and acquisition adjustment incentives for stand-alone transmission companies ("Transcos").
- Implement a uniform 100 basis-point ROE incentive for utilities that join or remain a member of a Regional Transmission Organization ("RTO") or Independent System Operator ("ISO"), regardless of whether such membership is voluntary.
- Offer a 100 basis-point ROE incentive and regulatory asset incentive for transmission technologies that enhance reliability, efficiency, and capacity, and improve the operation of new or existing transmission facilities.
- Establish a uniform 250 basis-point cap on total ROE incentives to replace the current ROE incentive ceiling based on the upper boundary of a utility's zone of reasonableness.
- Reform the FERC Form 730 (Report of Transmission Investment Activity) process to solicit information on a project-by-project basis, instead of the previous practice of collecting this information on an aggregated basis, and require additional information.[2]

The Commission invited comment from interested parties on these proposals and the details of their implementation. Initial comments are due July 1, 2020 (per the NOPR, this date is 90 days after its publication in the Federal Register).

As discussed more fully below, transmission incentives have significant financial and policy implications for a wide range of industry participants. The sheer scale and number of the proposed reforms ensures that they will garner numerous comments from diverse sectors of the industry. For this reason, it should be noted that the NOPR and the regulations it proposes are merely proposals at this point, and are not final. The Commission has left itself substantial leeway to modify the proposals included in the NOPR, and will consider comments from interested participants before announcing a final rule. In some cases, the NOPR's proposals embody concerns or statements made by the Commission in individual transmission incentive cases in recent years.

II. Major Reforms and Implications

FERC has proposed considerable revisions to its policy of granting project-specific ROE incentives. First, the Commission has proposed to discard its current risks and challenges inquiry in favor of an approach that assesses a transmission project's benefits.[3] This approach would replace the "nexus" test established by Order Nos. 679 and 679-A[4] with a more quantitative benefits test. FERC has identified two benefits that would warrant an ROE incentive pursuant to this assessment: (1) reducing the cost of delivered power by reducing transmission congestion; and (2) ensuring reliability.

Regarding the first benefit, the Commission proposes to offer an ROE incentive for a project's economic benefits measured by the degree to which they exceed the costs of related transmission projects.[5] The Commission breaks this economic ROE incentive into two parts. First, it will offer a 50 basis-point ROE incentive to transmission projects that meet an *ex ante* benefit-to-cost threshold. The Commission proposes to divide projects by size and has established a preliminary benchmark of $25 million to distinguish the costs of large and small projects. For both, the applicant must demonstrate

projected net benefit ratios consistent with the 75th percentile of all transmission projects developed in regional plans during the applicable study period.[6] Second, the Commission will offer an additional 50 basis-point ROE incentive for economic benefits as measured on an *ex post* basis. To receive this incentive as proposed, an applicant must demonstrate a benefit-to-cost ratio consistent with the 90th percentile of transmission projects at the time of completion, based on applying actual costs to projected benefits.[7]

Together, these economic ROE incentives have the potential to substantially increase the amount of additional revenue available to developers through transmission ROE incentives, as well as increase costs to transmission customers, compared to the current approach. Under the risks and challenges nexus test, the Commission rarely awards ROE incentives and typically caps the select few awarded at 50 basis points. While the comparability analysis referencing peer projects will serve to limit incentives, the potential pay-offs are much larger given the opportunity to receive a 100 basis-point total incentive. Further, the benefits-to-costs assessment will introduce a more quantitative analysis than the largely qualitative nexus test. This could translate to greater certainty as to which projects would merit an economic incentive. However, the Commission's development of the percentile thresholds and the appropriate study parameters are not plainly defined in the NOPR, and this area will likely draw significant comments as to the details of their implementation.

Regarding the second listed benefit, reliability, the Commission proposes to offer a separate ROE incentive of up to 50 basis points for projects that produce significant and demonstrable reliability benefits above and beyond the requirements of NERC standards.[8] The Commission provided a non-exhaustive list of the types of projects that would merit this incentive: (1) projects that significantly increase import or export capability between balancing authorities; (2) projects that result in an Interconnection Reliability Operating Limit being downgraded to a routine System Operating Limit; (3) projects that improve the bulk power system's ability to operate reliably during foreseen and unforeseen contingencies; (4) projects that reduce the transmission system's complexity by eliminating the need for one or more remedial action schemes; and (5) projects that use network management technologies such as dynamic line ratings, power flow controls, or transmission topology optimization. The Commission proposes that applicants support their incentive requests by providing quantitative analyses if possible, with a qualitative demonstration if necessary.

The Commission invited comment on other types of projects that could demonstrate reliability benefits, and noted that it would also consider the degree to which a project increases resiliency. This broad reliability standard could either signify a holistic assessment by FERC or indicate that the criteria will narrow considerably in a final rule.[9] The Commission's stated preference for a quantitative analysis suggests the latter and again demonstrates the Commission's emerging preference for more precise, quantifiable criteria. Nevertheless, given the broad standard announced in the NOPR, commenters may influence the direction the Commission may take in a final rule.

In addition to these benefits-based incentives, the Commission proposes to offer incentives for technologies that, as deployed in certain circumstances, enhance reliability, efficiency, capacity, and improve the operation of new or existing transmission facilities.[10] Applicants may seek two incentives related to such technology: (1) a 100 basis-point ROE incentive on the cost of the technology; and (2) two-year regulatory asset treatment for costs related to deploying and operating that technology. The Commission provided the following examples of worthy technologies: (1) advanced line rating management; (2) transmission topology optimization; and (3) power flow control. Notably, the Commission cautioned that it did not propose to award the incentive to technologies traditionally associated with the transportation of electric power, such as power lines, power poles, capacitors, and

other substation equipment. The Commission proposes to consider requests for the technology incentive on a case-by-case basis and notes that such requests will be subject to the benefits-to-cost analysis described above. These qualifiers again suggest that the Commission is attempting to move away from a qualitative approach to one grounded in a strict cost-benefits analysis. While this could provide a degree of certainty as to which projects merit an incentive, it could also eliminate any leeway to demonstrate that a project's unique attributes present benefits that are not easily quantifiable or predefined in the final rule.

In addition to these project-specific incentives, the Commission has proposed to modify its ROE incentive for participation in an RTO or ISO.[11] Specifically, the Commission proposes to award a fixed 100 basis-point ROE incentive for utilities that join or remain in an RTO or ISO. This incentive will be offered regardless of whether such participation is voluntary. The Commission justified this proposal based on the benefits RTOs and ISOs have consistently demonstrated since their inception, such as the reduced cost of delivered power due to broader and more robust access to power sources in a wide geographic footprint. Given the increasing responsibilities inherent to RTO/ISO membership, the Commission seeks to further incentivize participation.

This expanded incentive has already garnered significant controversy. Commissioner Glick dissented from the NOPR, partially based on this addition. He noted that "[t]here is nothing in the record to suggest that any transmission owner would leave an RTO if not for that handout," and added that, "[s]imply put, the Commission wants to double the cost to consumers of an 'incentive' that does not incentivize anything."[12] Some commenters will likely seize on this sentiment, given that FERC proposes to increase the typical RTO/ISO participation adder by 100%. Additionally, the Commission sought comment on whether and how to apply this incentive to existing rates.[13] This invitation will likely solicit substantial input from transmission customers and transmission owners alike given the broad applicability of the RTO/ISO participation adder and the significant impact the proposal would have on transmission rates and returns.

In light of these substantial changes to its ROE incentive policy, the Commission has proposed to revise the ceiling for ROE incentives.[14] Currently, the permissible amount of cumulative ROE incentive adders above the base ROE is capped at the upper boundary of a utility's zone of reasonableness. In the NOPR, the Commission proposes to eliminate this utility-specific ceiling for a uniform cap of 250 basis points above the utility's base ROE. The Commission explained that transmission incentives serve an incentivizing function, which differs from the base ROE's purpose of reflecting financial and regulatory risks. For this reason, the Commission believes that this incentive can be just and reasonable in a different manner than base ROE.

This proposed revision to the Commission's incentives policy is sure to draw significant scrutiny. Some will likely argue that it substitutes a one-size-fits-all standard that fails to account for utilities' individual attributes. Others may contend that the uniform cap levels the playing field and will no longer penalize utilities based on their unique risk profiles. In either case, the new ROE ceiling has the potential to significantly increase the amount to gain from transmission incentives. This will likely draw the ire of consumer advocates, but should satisfy transmission owners that stand to benefit from these incentives. Additionally, like the RTO/ISO incentive, the Commission seeks comment as to whether it should allow applicants previously subject to the zone of reasonableness ceiling to utilize the newly proposed cap.[15] Again, given the prevalence of currently operative transmission incentives, this inquiry will surely draw forceful opinions, and there remains significant uncertainty as to the details of how this would be implemented.

Lastly, the Commission has proposed to eliminate the ROE and acquisition adjustment incentives for Transcos.[16] The Commission claims that the Transco incentives have not had the desired effect that motivated their creation in Order No. 679. The Commission argued that, instead, "Transcos are deploying capital to support transmission development in a manner that is comparable and not significantly greater than that of their traditional public utility."[17] While the Transco incentives were premised on Transco independence, the Commission notes that the majority of Transcos have either originated as or become affiliates of integrated utilities. Finally, the Commission argues that the availability of these incentives simply has not spurred the formation of many Transcos. Despite proposing to discard these Transco-specific incentives, the Commission maintains that all other transmission incentives remain available to Transcos.

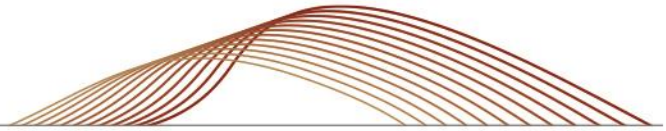
The Commission's proposed elimination of the Transco incentives leaves unanswered questions. Transcos will be eager to determine whether previously rewarded Transco incentives will continue in effect or whether the Commission will take retroactive action consistent with its proposals. The Commission invited comment on this point,[18] and it is sure to receive comments from Transcos and customers alike. Transcos will likely contest the Commission's assessment of the incentives' effect since their inception in Order No. 679, perhaps with reference to their record of participation in Order No. 1000 competitive processes.

Despite the proposed seismic changes to the ROE incentives described above, the Commission notes that it will continue to offer the following non-ROE incentives: Abandoned Plant Incentive, Construction Works In Progress Incentive, hypothetical capital structures, accelerated depreciation for rate recovery, and regulatory asset treatment.[19]

With respect to the Abandoned Plant Incentive, the Commission proposes to modify the eligibility period due to intervening changes in the transmission planning process since Order Nos. 679 and 679-A.[20] Specifically, for projects selected in a regional transmission planning process, the Commission proposes to change its current practice by moving the effective date from the date the Commission issues an order granting the incentive to the date the transmission project is selected in the regional transmission planning process for cost allocation purposes. The Commission explains that this would account for costs incurred after the project's approval by a regional transmission planning process, which are currently excluded. The Commission notes that "this delay is not warranted for purposes of cost control, because the transmission planner has made the decision to undertake the transmission project."[21] Although an FPA section 205 filing to recover such costs must still demonstrate that the transmission project was abandoned for reasons outside the applicant's control and that the costs incurred were prudent, the Commission's proposal as written appears to eliminate the requirement that an RTO/ISO-approved project receive preliminary Commission approval to be eligible. If so, this would relieve applicants of an extra filing burden. Overall, this proposal would serve to increase the costs that could be recovered in the event a project is abandoned beyond the applicant's control and would benefit those transmission projects developed in an RTO/ISO transmission planning process.

III. Conclusion

As the NOPR's primary effect is to increase opportunities for larger ROE incentives, while tightening or even eliminating other available incentives, the financial implications for both transmission developers and owners and transmission customers are significant. In some cases, the Commission has provided fairly specific new or revised incentives and the eligibility criteria that must be satisfied. In others, the reform is more conceptual, with an invitation for comments to flesh out how the change in incentive policy should be implemented. In either case, there is plenty for industry participants to focus on and



to provide comments to the Commission in those areas. The proposed reforms will impact billions of dollars of investment in a key infrastructure sector of our nation's economy and will ripple throughout all sectors of the electric power industry. Given the transmission-friendly proposals the NOPR presents, the outcome is likely to encourage additional investment in this sector. With the significant amount of money at stake and the wide-ranging effect, many affected stakeholders will seek to comment on the NOPR's proposals, either individually or in conjunction with industry groups. The NOPR process is the perfect opportunity for stakeholders to submit comments expressing their positions or at least monitor the filed comments and any Commission pronouncements as the process unfolds. This NOPR is the final procedural step and thus the last opportunity to comment before the Commission determines whether to adopt these proposals in a rule.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings Washington, D.C. lawyers:

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[1] *Electric Transmission Incentives Policy Under Section 219 of the Federal Power Act*, 170 FERC ¶ 61,204 (2020) (NOPR).

[2] *Id*. PP 3-11.

[3] *Id*. PP 34-40.

[4] *Promoting Transmission Investment through Pricing Reform*, Order No. 679, 116 FERC ¶ 61,057, *order on reh'g*, Order No. 679-A, 117 FERC ¶ 61,345 (2006), *order on reh'g*, 119 FERC ¶ 61,062 (2007).

[5] NOPR at PP 42-62.

[6] FERC stated that it examined 41 economic transmission projects selected in the regional transmission plans of MISO, CAISO, and PJM from 2013 through 2019 and developed the following preliminary 75th percentile-thresholds: 3.98 for projects larger than $25 million and 33.91 for projects less than or equal to $25 million. *Id*. PP 57-58.

[7] For the study period, the 90th percentile for projects greater than $25 million is 5.17. It is 77.04 for projects less than or equal to $25 million. *Id*. P 59.

[8] *Id*. PP 65-75.

[9] *Id*. P 75.

[10] *Id*. PP 100-110.

[11] *Id*. PP 92-99.

[12] Commissioner Richard Glick, Statement on COVID-19 & FERC Orders (Mar. 19, 2020), *available* at https://www.ferc.gov/media/statements-speeches/glick/2020/03-19-20-glick.asp#.Xn33WYhKg2w.

[13] NOPR at P 99.

[14] *Id*. PP 76-81.

[15] *Id*. P 81.

[16] *Id*. PP 85-91.

[17] *Id*. P 88.

[18] *Id*. P 91.

[19] *Id*. P 82.

[20] *Id*. P 84.

[21] *Id*.