

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Promoting Transmission)
Investment Through)
Pricing Reform) **Docket No. RM06-4-000**

COMMENTS OF THE
COMMITTEE ON REGIONAL ELECTRIC POWER COOPERATION

Pursuant to the Commission’s Notice of Proposed Rulemaking (“NOPR”) issued in the above-referenced docket November 18, 2005, the Committee on Regional Electric Power Cooperation (CREPC) respectfully files the following comments.

SUMMARY OF COMMENTS

- Policies to increase the Return on Equity (ROE) on transmission investment or create hypothetical capital structures for certain transmission projects are generally not efficient or cost-effective methods to stimulate transmission expansion.
- If the Commission proceeds with a policy to provide ROE adders or hypothetical capital structures to certain transmission projects, it should develop appropriate criteria and a process to determine which projects warrant such financial treatment.

- The Commission should seek to promote federal and state/provincial cooperation to improve regulatory consistency and address other barriers to transmission investment. The Commission should form joint panels to develop and recommend appropriate mechanisms that will enable cost recovery of economic transmission investments and bring more certainty to the process.
- The Commission should reduce the risk of transmission investment by supporting regional transmission planning efforts that are transparent, inclusive and use publicly available data.
- The Commission should adopt transmission policies that support state and provincial policies to develop renewable energy resources.

I. INTRODUCTION

CREPC is a joint committee of the Western Interstate Energy Board and the Western Conference of Public Service Commissioners. It was formed in 1983. All regulatory, energy planning and siting agencies in the states and provinces in the Western Interconnection are eligible to participate in CREPC. Positions are taken by CREPC only if no state or province objects. The Western Interstate Energy Board is an organization of 12 Western states (AZ, CA, CO, ID, MT, NE, NV, NM, OR, UT, WA, WY) and three Western Canadian Provinces (AB, BC, SK). Its members are appointed by the Governor or Premier. Its legal basis is an interstate compact approved by 12 states and Congress (PL 91-461). The Board serves as the technical energy arm of the Western Governors' Association. The Western Conference of Public Service Commissioners includes the PUCs from 11 states (AZ, CA, CO, ID, MT, NV, NM, OR, UT, WA, WY).

Each Western state or province may be offering its own responses to the issues raised in the NOPR. CREPC offers the following observations and recommendations that reflect a consensus regional perspective of the states and provinces linked by the Western Interconnection.

The Western Governors' Association (WGA) is pursuing the Clean and Diversified Energy Initiative which seeks to add 30,000 MW of clean and diversified energy in 18 western states by 2015. CREPC has participated in this effort. CREPC's comments on this NOPR build, in part, upon the discussions with industry and the WGA task force recommendations that relate to transmission expansion to support new clean and diversified energy resources.

II. STATEMENT OF CONCERN

CREPC's goal for energy policy is to ensure reliable and affordable power. CREPC encourages good and prudent investment decisions to advance this goal while ensuring ratepayers are protected by just and reasonable rates. CREPC shares the Commission's goal of promoting timely and efficient investment in transmission. Encouraging investment in transmission infrastructure is an important component of comprehensive solutions to provide reliable and affordable supplies to customers. However, responsible planning must include consideration not just of transmission, but also alternative investments in fuel resources, generation location, and energy efficiency initiatives. CREPC supports a broad strategy to improve planning and coordination among western entities that will enhance the transmission system, and thereby enable the region to shift away from high-cost gas-fired generation towards clean and diversified energy resources in the West.

CREPC is concerned that some of the proposed policy changes in the Commission's NOPR are inefficient mechanisms that may stimulate uneconomic investment in transmission facilities. CREPC encourages the Commission to reject the use of the blunt and nonselective policy instruments under consideration and discussed below. In the following section (Part III), we offer recommendations for a more effective strategy that reduces risk associated with transmission investment.

CREPC does not share the NOPR's assessment that, in general, the prevailing rates of return on equity (ROE) are insufficient to attract capital and therefore an impediment to transmission investment. In the 1970s and 1980s the Western transmission system grew significantly to accommodate the long distances between new coal generation and load centers. Individual companies invested to expand the grid to meet their increasing demands. In 1996, FERC initiated the policy of open access transmission under Orders 888/889 to enable a more competitive wholesale electric power market. The transmission system was called upon to make a fundamental transition to a competitive market during a period of critical institutional changes. In the late 1990s and early 2000s, nearly all new generation in the West was fueled with natural gas. These plants were typically built near load centers. Whether or not new transmission was needed is subject to debate but little was added. In the last three years, high natural gas prices and the prospect that they may remain high have altered the economic parameters and stimulated new interest in other generating resources, particularly coal and wind energy.

Several western transmission planning studies indicate that transmission expansion to diversify the generation resources away from natural gas will yield benefits

to the region.¹ A growing number of large interstate transmission projects have been announced and proposed including Palo Verde-Devers II, Northern Lights, Frontier Line, TransWest Express and various projects undertaken by the Bonneville Power Administration (BPA) and the Western Power Administration (Western). These new transmission proposals are often driven by factors other than ROE and hypothetical capital structures. In fact, because BPA, Western and other public entities do not earn a return on equity, such financial incentives would be irrelevant for those important projects. We believe that financial capital is likely to find and support those projects that are worth building to link new generation resources to the loads willing to pay for them. Incentives may be needed for special projects like the Path 15 upgrade that helped alleviate an important constrained path in California.

An increase in the ROE is not always the most efficient and cost-effective way of encouraging economic transmission expansion. The proposed hypothetical capital structure policy is simply an alternative bookkeeping tool to increase the effective return to project investors. Simply providing a financial windfall will not always resolve the real impediments to new transmission. Rather, the Commission should focus on reducing specific project uncertainties as a means of encouraging economic investment in transmission.

¹ Western Governors' Association, *Conceptual Transmission Plans for Electricity Transmission in the West*, August 2001 (WGA 2001)

(http://www.westgov.org/wga/initiatives/energy/transmission_rpt.pdf);

Seams Steering Group-Western Interconnection, *Framework for Expansion of the Western Interconnection System*, October 2003 (SSG-WI 2003) (http://www.ssg-wi.com/documents/316-FERC_Filing_103103_FINAL_TransmissionReport.pdf);

RMATS Phase I Report, Rocky Mountain Area Transmission Study, September 2004 (RMATS) (<http://psc.state.wy.us/htdocs/subregional/Reports.htm>);

The evaluation of project risk is an extremely important part of decision-making for investors who, through diversification, are best suited to managing risk. Allocation of risk to other parties, for example by guaranteeing cost recovery for cancelled projects, or by guaranteeing full cost recovery regardless of the timing, cost or amount of use of the project, allows investors to ignore risk and places it on parties who are unable to manage the risk. In encouraging transmission investment, the Commission should neither shift risk away from investors to consumers in a way that does away with the incentive to make efficient decisions, nor should it indiscriminately reduce risk and increase the return on transmission investment. The Commission should instead foster a climate that is more certain and conducive to investment by promoting federal and state/provincial cooperation to improve regulatory consistency and by encouraging transparent planning that identifies the need for projects.

If the Commission does proceed with a policy to provide ROE adders or hypothetical capital structures to certain transmission projects, it should develop appropriate criteria and a process to determine which projects warrant such financial treatment. A process to determine criteria for a specific project should be done in consultation with our proposed joint state/provincial and Commission panels. The Commission must ensure that any process it adopts does not simply result in enabling otherwise uneconomic projects to be built.

CREPC does not believe a blanket ROE increase or a hypothetical capital structure are necessary or appropriate for all new potential transmission projects. These mechanisms generally run counter to the Commission's goal of encouraging transmission investment that is in the public interest as they will either unnecessarily increase the cost

of electricity to end users or render an otherwise economic transmission project uneconomic in comparison to its alternatives, e.g., the alternative of locating gas-fired generation close to load.

We have developed a specific set of recommendations we believe should be adopted to promote transmission expansion. Any premium rates of return on investment should be utilized only if and when there is a demonstrated need for such policy action based on the criteria developed by the joint panels.

III. RECOMMENDATIONS

CREPC seeks to promote efficient and cost-effective transmission expansion. CREPC recommends a strategy based on the following three points: A) reduce risk of transmission investment by improving federal and state/provincial coordination; B) improve regional transmission planning; C) support state and provincial energy policies to develop clean energy.

A. Reducing Risk in Transmission Investment by Improving Federal and State/Province Coordination

The federal government and state/provincial governments regulate different areas of the electric industry, and both influence decisions regarding transmission investments. Improved federal and state/provincial coordination on transmission issues could enhance developer and investor confidence.

The Commission should form regional joint state/provincial and Commission panels to develop and recommend appropriate mechanisms that will enable consistency in cost recovery of interstate transmission investments. These panels could facilitate agreements among federal, state and provincial regulators. Consistent cost recovery

policies will provide greater certainty to transmission developers, state infrastructure authorities, and project investors. The panels should also explicitly review and consider the risks and need for a variety of policies such as the following:

1. Forms of project approval, alternative rates of return on transmission investments, consideration of project incentives, and timely cost recovery of transmission investments.
2. Transmission pricing that reflects the following principles: (a) fair cost allocation; (b) minimal cost shifting; (c) recovery of prudent costs; and (d) efficient siting and construction of new transmission and generation facilities.
3. Coordination of Commission, state, and provincial policies for the recovery of appropriate and prudent costs.
4. Appropriate methods of dealing with financing during a project's development and construction.
5. Coordination on pricing principles to be adopted by groups of states and provinces, and the Commission.²
6. Future efforts to define the physical and/or financial rights that accrue to a market participant making a transmission infrastructure investment.

² For example, CREPC formed the Transmission Regulatory Principles (TREG) work group in 2004 to explore regulatory issues concerning transmission in response to a recommendation of the Rocky Mountain Area Transmission Study (RMATS). TREG consists of representatives from regulatory commissions from five states (WY, UT, MT, ID and NV). This work group has been examining existing regulatory cost recovery processes, drawing upon case studies of actual historical transmission cost recovery decisions, identifying emerging issues related to transmission, and developing common cost allocation principles for a potential future memorandum of understanding among states and possibly with FERC. The TREG effort seeks to improve regulatory review and coordination for future transmission projects, and thereby reduce developer risk associated with such investments.

7. Coordinated state and federal efforts to facilitate the siting of interstate transmission projects.³

B. Improving the Transmission Planning Process

Transmission investments need to be considered in the context of the whole integrated energy system.⁴ Since the electricity crisis of 2000-2001, CREPC has collaborated with Western Governors to improve the western electric system by supporting integrated resource planning (IRPs) by load serving entities (LSEs), and transparent stakeholder-driven regional transmission planning. IRP planning encourages least cost solutions based on a comprehensive analysis of options that generally includes an assessment of generation, transmission, loads and demand-side investments.

The West has been pursuing numerous transparent, stakeholder-driven regional transmission planning efforts since 2001. In the Western Interconnection, regional transmission planning studies have been conducted by the Seams Steering Group-Western Interconnection (SSG-WI). Six sub-regional transmission planning organizations have formed to conduct planning studies and identify potential transmission projects.⁵ These Western transmission planning processes have begun to result in investment enhancements to the existing system, detailed feasibility studies of major new infrastructure additions and major proposed projects. Coordination of future interconnection-wide planning is shifting to the Western Electricity Coordinating Council

³ See the Protocol on Siting and Permitting of Interstate Electric Transmission Lines in the Western United States among the members of the Western Governors' Association, Alberta, U.S. Department of Interior, U.S. Department of Agriculture, U.S. Department of Energy, and the Council on Environmental Quality. (<http://www.westgov.org/wieb/electric/Transmission%20Protocol/index.htm>)

⁴ For example, congestion need not occur 100% of the time to make upgrading advisable. See the discussion of Congestion and Congestion Costs beginning at page 2-9 of the *RMATS Phase I Report*, referenced in footnote 1 above.

⁵ Southwest Area Transmission (SWAT); Southwest Transmission Expansion Plan (STEP); Rocky Mountain Area Transmission Study (RMATS); the Northwest Transmission Area Committee (NTAC); the Colorado Coordinated Planning Group (CCPG); and the California ISO.

(WECC). CREPC supports WECC's decision to undertake a role in regional transmission planning and urges the Commission to endorse and support this decision because open regional planning processes are the lynchpin of good transmission investment decisions.

It is critical that the Commission ensure, through oversight of the Electricity Reliability Organization (ERO), that future transmission planning has stable, adequate funding, and relies on publicly available data applied in transparent analyses. Paramount to the success of this new planning role for WECC will be a requirement for an inclusive and open planning process that can lead to analytic and multi-jurisdictional consensus on efficient and prudent investments in transmission.

C. Support State and Provincial Efforts to Coordinate Transmission with Clean Energy Policies

The Western Governors adopted the goal of adding 30,000 MW of new clean and diversified generation capacity across the WGA states by 2015. States and provinces have sought to expand renewable energy by different policy means. Six states in the Western Interconnection have adopted renewable portfolio standards (RPS).⁶ States that have adopted RPS goals and related policies have expressed a general public interest policy of expanding the use of clean renewable energy. Some states use the IRP process to diversify energy and encourage renewable resources. Other states and provinces seek to expand renewable resources for different energy policy objectives.⁷

⁶ The six Western Interconnection states with RPS policies are Arizona, California, Colorado, Montana, Nevada, and New Mexico.

⁷ Oregon, Washington and California are collaborating on policies under the West Coast Governors' Global Warming Initiative. Wyoming has an interest to develop wind resources for export to other western states.

Development of renewable resources such as wind and geothermal projects typically occurs through multiple small projects developed by different entities on a decentralized scale. Current Commission rules on generator interconnection and cost recovery place significant responsibility for transmission project financing on project developers. It is difficult for multiple parties pursuing development of small, decentralized projects to negotiate and finance large-scale transmission projects. Consequently, in authorizing rate recovery for such projects the Commission should defer to state law and state commission decisions.

The Commission should also support state and provincial regulatory decisions to approve transmission construction in advance of generation to enable the modular development of location-constrained, renewable resource areas to meet RPSs and comply with state-approved LSE resource plans. Examples of such actions are the proposal by Southern California Edison for a renewable trunk line (Tehachapi model), Texas legislation (SB 20) that plans for transmission to designated renewable energy zones, and Minnesota legislation (SF 1368) that supports transmission planning to attain renewable energy goals. However, the Commission should not impose mandatory cost recovery for projects built in advance of need where states have not approved such actions, as it would interfere with appropriate risk evaluations by those parties best suited to make them.

CREPC respectfully requests that the Commission consider the above comments and recommendations in this proceeding.